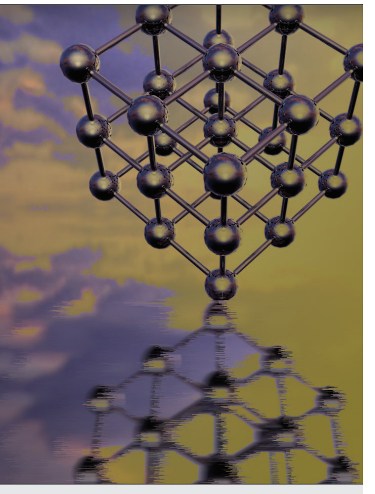
Chemical Customer Connectivity Index—C3X

Knowing what matters to your customers

The economic turmoil of the past year has roiled global markets, but in the European chemical industry there are signs that the recession is finally lifting. Many companies are reporting an improvement in order numbers, and many have begun to phase out the reduced working hours they introduced to counter the crisis. For chemical suppliers and their customers, the pressing question of the day is: Do these signs portend the beginning of a long-term recovery, or is the crisis just taking a breather?



Chemical companies that optimize their operations—making their processes and production cycles more flexible and preparing for future challenges—will gain a distinct competitive advantage.

Recent media reports contend the European chemical industry is showing tentative signs of recovery, but that it will take years before the industry gets back to its January 2008 peak. Assuming that this is true, what must chemical companies do to stand up to the long-term challenge of this economic environment?

To answer this question and others, A.T. Kearney, CHEManager Europe and the Westfälische Wilhelms-Universität Münster, performed the third Chemical Customer Connectivity Index (C3X), a survey of top management in the chemical industry *(see sidebar: About C3X)*. The Index finds that three-quarters of suppliers and more than 80 percent of their customers report slumps in demand of between minus-10 and minus-50 percent during the recession *(see figure 1 on the following page)*. They also report key lessons learned in the aftermath of the economic crisis. Specifically, flexibility and agility—adapting seamlessly to changing economic conditions and fluctuating demand—are major success factors for gaining competitive advantage *(see figure 2 on the following page)*.

This paper summarizes the C3X, examining the customer-supplier relationship in the European chemical industry, assessing the impact of the economic crisis, and focusing on how companies are reacting to the post-crisis world.

A Tentative Revival

Despite the bleak conditions, many respondents confirm a certain degree of relief. In March, expectations about future demand were dismal, yet today 80 percent of manufacturers and 60 percent of customers expect demand to rise *(see figure 3 on the following page)*. After a months-long slide, the industry seems to have bounced back from the bottom.

This, however, mustn't give rise to hasty euphoria. About 40 percent of suppliers and 25 percent of

FIGURE 1: How has the financial crisis affected industry demand?

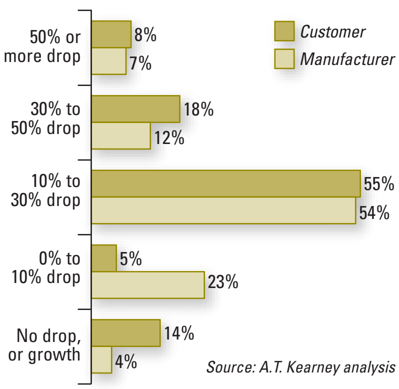


FIGURE 2: Lessons from the crisis

Note: Multiple answers possible
Source: A.T. Kearney analysis

customers do not believe their firms have adequate capabilities to weather another economic crisis if it hit today *(see figure 4)*. And the survey suggests that the rise in demand might be overestimated, related to the restocking effect that follows the drastic destocking that occurred at the outset of the crisis. Customers' more tempered expectations probably paint a more realistic picture of the current market situation.

The general optimism is backed up by the fact that 90 percent of survey participants expect raw material prices to increase, suggesting that conditions favor high-volume purchases at attractive prices. But with volatility likely to continue, end-to-end risk management is required to reduce exposure to the uncertainty that remains on the buy and sell sides.

Weathering the Downturn

Most executives say they are pleased with their companies' efforts to confront the downturn. Three-quarters of manufacturers and more than 80 percent of customers report that their measures have been "mostly" or "completely" successful. Altogether, companies are meeting cost savings targets by at least 70 percent.

Roughly one-third of respondents say their response to the downturn has concentrated mainly on low- and high-effort short-term measures. The immediacy highlights how the severity of the crisis caught the industry off-guard. Nevertheless, this short-term focus was the only way for most to move forward. Over half of respondents have already begun this move forward, which for most means a balance of short- and long-term high-effort measures. A sustainable restructuring approach that aligns short-term measures to ensure liquidity and profitability with a solid, long-term corporate strategy is crucial.

In terms of specific moves in response to the crisis, the vast majority—89 percent of manufacturers and 87 percent of customers—have mainly focused on optimizing their operations *(see figure 5)*. As in March, the second most common response for companies is improving the customer interface, although this dipped to 40 percent from 50 percent.

Customers' responses to the crisis demonstrate two striking developments. First, more say they are considering mergers and acquisitions (M&A)—35 percent in this survey compared with 15 percent in March. This suggests that financially healthy companies are increasingly ready to integrate either backward or forward along the value chain. Second, carefully selecting suppliers has nearly doubled in value to customers, from 33 percent in March to 61 percent in this survey.

Also telling are the areas customers believe suppliers should address. Sixty percent of customers, for example, want suppliers to address the IT

FIGURE 3: Manufacturers and customers expect demand to rise

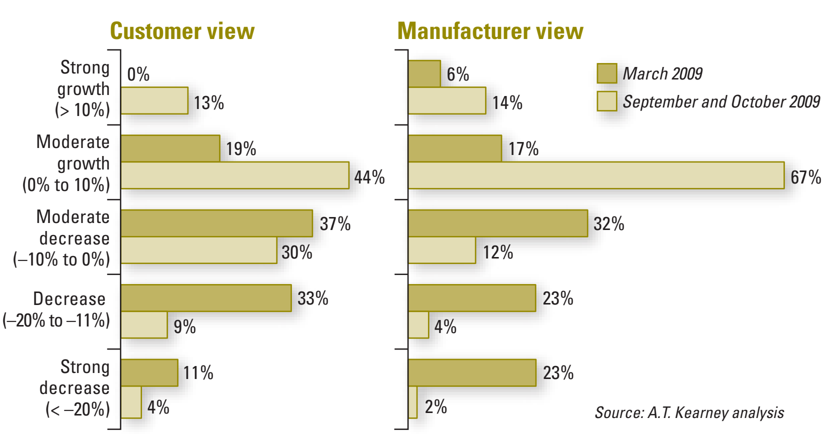
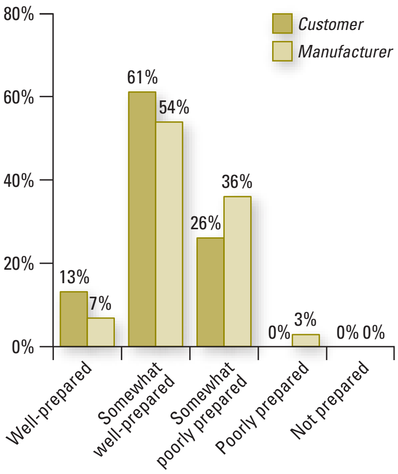
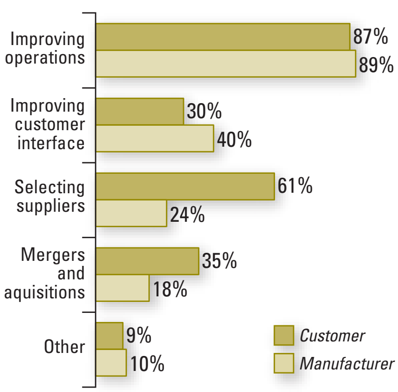


FIGURE 4: How well prepared are you for further challenges?



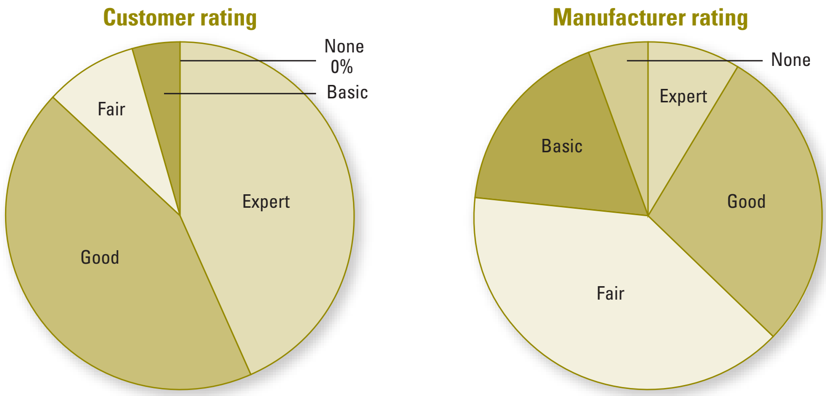
Source: A.T. Kearney analysis

FIGURE 5: Specific moves in response to the crisis



Note: Multiple answers possible
Source: A.T. Kearney analysis

FIGURE 6: How do you rate your knowledge of your customers' customers?



Source: A.T. Kearney analysis

interface more aggressively; only one-quarter are doing so. This means that manufacturers have a different understanding of "process excellence" than their customers and a less holistic view of the value chain and its interfaces. This disconnect represents an opportunity to satisfy customers' needs and increase competitive advantage by better understanding customers' value chains. Manufacturing executives seem to know that their firms can get a better understanding of their customers' processes and value chains—only one-third rate their company as having excellent or good knowledge of their customer's customers *(see figure 6)*.

A wide gap exists in sales force efficiency, which suppliers value far more than customers. Even though sales staff seems to be performing better, suppliers remain somewhat uncertain about what their customers truly want, for example, innovative pricing models or cooperation across companies' interfaces.

Customers' Buying Criteria

Among customer priorities, improved pricing remains crucial. In this context suppliers should know that today's customers are as interested in paying for volume as paying for performance. In terms of pricing, more customers are obviously challenging not only commodities but also specialty products. This demonstrates a paradigm shift in which, during these tight times, making more complex specialty products alone is not enough to justify a price premium.

On the other hand, executives consider availability as a bigger buying priority today—perhaps a sign that customers are preparing for the restocking phase. As restocking occurs along the value chain, availability bottlenecks are likely, and the leaders will stand out by demonstrating agility in their supply chains to cover increased

About C3X

The C3X analyzes the chemical industry from the vantage point of chemical companies and their customers. The panel includes European chemical industry senior executives and decision-makers. Participants in this third C3X, conducted from mid-September to mid-October 2009, include roughly 120 executives from 15 European countries, representing chemical firms and client companies covering ten different sectors, including automotive, food and cosmetics. The first C3X was released in October 2008, and the second in March 2009.

demand, even as the market remains unpredictable.

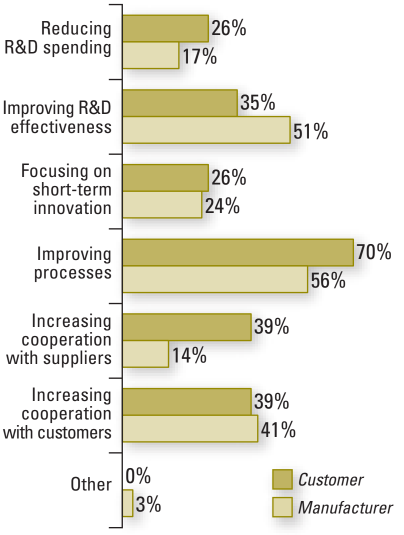
A major gap persists regarding sustainability. Customers continue to value it much higher than suppliers—57 percent to 36 percent. This topic offers manufacturers potential for competitive advantage and improved market position.

In terms of innovation, there was a slowdown, as expected. More than 60 percent of suppliers and customers have either reduced or optimized their research and development (R&D) spending *(see figure 7)*. However, there are signs of an innovation uptick. Customers say they want new products, an area that slipped at the beginning of the crisis. Customers are presuming their suppliers have recovered from the worst of the crisis, and they still want those game-changing innovations that can give them a competitive edge.

Prepared for the Next Crisis?

As noted earlier, many in the chemical industry do not believe their companies would be ready for another crisis if it hit today. But the C3X shows that the leaders at chemical firms see a light at the end of the tunnel. A sustainable recovery will require additional work, however. While there is no single panacea, companies that optimize their operations—making their processes and production cycles more flexible and preparing for future challenges—will gain a competitive advantage. Improving agility is the order of the day.

FIGURE 7: Companies are less focused on innovation



Note: Multiple answers possible
Source: A.T. Kearney analysis

Authors

***Thomas Rings** is a partner in the Munich office and head of the firm's Process Industries practice. He can be reached at thomas.rings@atkearney.com..*

***Louis Besland** is a partner in the Paris office. He can be reached at louis.besland@atkearney.com.*

***Tobias Lewe** is a partner in the Dusseldorf office. He can be reached at tobias.lewe@atkearney.com.*

***Marc Vathauer** is a consultant in the Frankfurt office. He can be reached at marc.vathauer@atkearney.com.*

A.T. Kearney is a global strategic management consulting firm known for helping clients gain lasting results through a unique combination of strategic insight and collaborative working style. The firm was established in 1926 to provide management advice concerning issues on the CEO's agenda. Today, we serve the largest global clients in all major industries. A.T. Kearney's offices are located in major business centers in 35 countries.

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

1 312 648 0111
email: insight@atkearney.com
www.atkearney.com