Specialty Chemicals In China

Faster Than Industry Average
Generally, the chemical industry in any given country starts with basic chemicals and moves on to higher-value chemicals later. Accordingly, in China, more than 50% of chemical sales come from basic chemicals, while in Japan the figure is around 40%. As China’s development proceeds, specialty chemicals will therefore grow faster than the chemical industry average. According to the National Bureau of Statistics of China, revenue growth in specialty chemicals was 21% for specialty chemicals but only 7% for the average of the chemical industry. So China’s specialty chemicals segment is highly attractive due to its high growth rate. This attractiveness is also reflected in direct investment of foreign specialty chemicals companies.

High-Growth, High Fragmentation

Specialty chemicals companies in China have a somewhat higher profitability than the chemicals average. However, this difference in not huge, most likely as other factors such as the small average company size in specialty chemicals lower the average profitability.

Another characteristic is the intense fragmentation of the specialty chemicals industry. There are almost 10,000 domestic specialty chemicals companies in China, far more than for any other chemical segment. Even the biggest specialty chemicals company such as Zhujian Chuanhua account for less than 2% of the total segment sales. And clearly China does not yet have companies that are as prominent as global leaders such as BASF, Glaxo, DSM, Evonik, Illidia or Wacker.

Domestic specialty chemicals companies have a low average technological level. This refers to all relevant aspects such as the technological level, their portfolio, their level of customer service and their capability to provide complete solutions to customers. Therefore they can not fulfill the needs of the domestic Chinese market. In many segments, China relies on either locally produced chemicals of MMOs or even on imported materials for high-end chemicals.

Probable as a consequence, government policy is promoting a gradual shift of the chemical industry towards specialty chemicals. This is part of a general trend to move away from large-scale and often polluting primary chemicals to high-value-added, high-end chemical products.

United Front of Big Chinese Players

Given the attractive market conditions, it is surprising that there are no truly big domestic Chinese specialty companies. Even the biggest domestic players have market shares well below 1% of the total specialty chemicals market and sales far below one billion dollars. Given that individual business units of multinational players often achieve far higher revenues, the key question is what keeps Chinese companies from becoming truly relevant players in specialty chemicals. Likely reasons are:

- Lack of strong R&D competence: China’s chemical industry is still at a relatively early development stage. Domestic companies have not yet accumulated the wealth of knowledge that enables Western companies to continuously pursue innovation. Furthermore, the mindset of Chinese companies sometimes seems to be too focused on physical assets rather than on intellectual property. This may be a consequence of the somewhat limited protection of intellectual property in China.
- Lack of long-term thinking: Chinese chemical companies sometimes lack the necessary longer-term thinking to pursue an area such as specialty chemicals, in which any success will only come after years of efforts to establish the business. Lack of global reach: Most Chinese chemical companies so far simply lack the marketing and sales network to market products globally. This is not a problem for basic chemicals with a strong domestic demand, but a severe limitation for smaller markets that need to be penetrated globally to reach a profitable level of sales.
- Lack of size: This is necessary not only due to the need for global presence, but also as customers more and more expect specialty chemicals companies to provide complete solutions to an industry. The intense fragmentation of the domestic specialty chemicals industry is a major obstacle to reaching critical size.
- Major Chinese companies prefer to focus on basic chemicals that offer less fragmented and less complex markets which at the same time are much larger.

And Why The Will Change

Despite these reasons, it is surprising that so far no major Chinese chemical company has established itself as a major player for specialty chemicals. After all, a smaller player should enjoy the higher growth profitability of the segment and also have a number of advantages compared to multinationals.

Specialty chemicals is relatively labor intensive, allowing a Chinese player to benefit from lower labor cost. This is relevant even if multinational companies start to produce specialty chemicals in China, as these costs are generally higher.

Furthermore, success in specialty chemicals depends on understanding specific markets and customers, and providing localized services to them. This should also be easier to be achieved by a truly local company than by a multinational.

What Will Happen Next?

It is to be expected that a few Chinese companies will come to realize the opportunities of becoming a leading player in specialty chemistries. This will first require establishing a clear specialty-focused strategy, which may not be easy given the relatively opportunistic approach of Chinese companies to business planning. In addition, it will be necessary to quickly expand the business. Relying on internal growth alone will not be sufficient as the current gap in the specialty chemicals industry will not be bridged for more than a couple of years.

Domestic mergers and acquisitions also probably will not be sufficient to become a leading player as most domestic acquisition targets themselves lack the deep specialty chemicals expertise. This leaves several qualifications that should be met. The company should have a certain size already in order to reach critical mass quickly, and at the same time should be willing to be focused. It will probably not be possible to become the domestic specialty chemicals champion while at the same time still pursuing several other strategic goals. Furthermore, the company should have a mindset that encourages innovation and research, focusing more on intellectual property than on physical assets and be willing to invest in providing technical service.

Finally, the company should ideally already have some international experience as a successful specialty chemicals company will need to target global markets.

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