Dreamstime

Different Approaches for a Complex Sector

Strategy Development in China's Chemical Industry by Foreign and Domestic Companies

By Kai Pflug

Analysing the market environment is arguably one of the most challenging parts of strategy development for the chemical industry in China. The reasons are manifold:

- Market demands, competitors, and customers change much more rapidly in China than in developed markets;
- Depending on the specific chemical product, many substantially different target markets need to be examined. For example, major applications of the aroma chemical vanillin include not only food and feed but also pharma and cosmetics;
- Chemicals tend to be part of complex value chains – they are rarely sold directly to the end customer but usually are used as raw materials for other products. In addition, traders and distributors are often involved. In China, there is an added level of complexity due to the broader variety of company types involved in the market (not just private companies but also state-owned enterprises (SOEs));
- Government policy has a stronger influence than in Western markets. For example, it is likely that the strong emphasis of many domestic chemical companies on pushing coal chemistry is derived from a presumed government interest in this topic. Similarly, many multinational corporations (MNCs) have recently considered setting up production in China's western provinces in order to align themselves with government policy of promoting these areas;
- Reliable data is still hard to come by in China, though the situation is improving somewhat. Any data available – whether customs statistics or data coming from industry organisations – has to be checked for its consistency and reliability;
- There are many unofficial but sometimes extremely useful data sources that may or may not be available, eg, customer lists of individual chemical companies;
- Due to the lack of official data, other sources such as phone interviews, face-to-face interviews, fair visits, local newspaper reports, etc. are more relevant than when examining Western markets;
- Even consultancies specialising in market analysis may not provide reliable data. This goes as far as domestic consulting companies essentially inventing the names of supposed market participants. Another problem is that information gathered confidentially for a specific client sometimes is offered online to third parties as well.

With regard to market analysis, local chemical companies tend to be better placed than MNCs as they often have better access to local industry organisations, customers, etc. and a better inherent understanding of the difficulties in getting reliable information in China. On the other hand, their data collection processes frequently lack the rigidity that Western companies apply, and thus sometimes fail to uncover gaps between companies' perceptions of the market and market realities. Correspondingly, Western companies do better concerning the formalisation of the analytical process but have a harder time getting difficult-to-access information or evaluating unreliable information.

Understanding the Own Company

Keeping in mind that strategic choices are best derived from a fit between internal capabilities and external opportunities, an analysis of internal strengths and weaknesses is vital to gain competitive advantage. In this respect, however, domestic Chinese chemical companies and MNCs operating in China show fundamental differences.

MNCs do indeed include this analysis in their strategy development. For example, Lyondell Basell established polypropylene compounding sites in China not only because of the market opportunities, but also because the company has knowledge in making these compounds that is superior to that of domestic companies. Some companies even rely on their internal capabilities too much, as was the case with a big US MNC with a strong history of technological innovation, to the point where they do not gather enough market information. They thus run the risk of providing products that are over-engineered for the Chinese market and not cost competitive.

By contrast, Chinese chemical companies spend very little time on the evaluation of their internal capabilities. Among them, there seems to be a strong feeling that if the market environment is right, a business opportunity should be grasped regardless of whether their own company has any specific competitive advantage in this area.

There are several possible reasons for this focus of Chinese companies on external factors rather than internal ones:

- Many companies, particularly SOEs, have a very broad business scope. For example, Sinochem is not only active in chemicals but also in real estate, logistics, fertilisers, energy, and finance. Such a broad scope encourages a broad-based search for market opportunities. By contrast, a Western specialty chemicals producer such as Altana has only a limited number of clearly defined focus segments.
- In addition, particularly for private domestic companies, there is limited company history that could serve as a guideline for future strategy.
- The key element is probably that Chinese chemical companies rely less on immaterial (and thus hard to gain) internal capital such as intellectual property, strong research and design (R&D), or the technical knowledge of their employees than MNCs.

There is an obvious consequence to the limited importance Chinese chemical companies place on internal capabilities. The analysis of chemical markets should give comparable results independent of which company conducts the analysis.

Strategy Development

The strategy development process as currently taught in business schools and universities may be described as consisting of three phases:

- An analysis phase, in which the external environment (eg, markets, competitors) and the internal capabilities of the company (eg, strengths, core competencies) are examined;
- A selection phase, in which the business strategy is determined;
- An implementation phase, in which selected option(s) are put into action.

However, such a generic perspective is of limited value to the practitioner. In reality the different phases are strongly influenced by the specifics of the industry and the region considered. This article examines some of these specifics as relevant to the chemical industry in China, particularly with regard to the first two phases outlined above. The implementation phase is also highly relevant but more related to day-to-day business activities and thus somewhat outside of the scope of the article.

A particular focus is put on the differences in the strategy development process between chemical multinational companies (MNCs) and domestic chemical companies. While many of these differences may also be observable in other industries, they are essential for any chemicals company to consider.

Therefore, if this is the sole factor determining company strategy, Chinese chemical companies should all pursue similar strategies. Indeed, this "strategic crowding" can frequently be observed in the Chinese chemical industry. Often there is a rush towards seemingly appealing areas (past examples include PE, PP, coal chemistry, and vanillin) by many companies and the subsequent creation of substantial overcapacity.

Striving for Localisation: China Strategies of MNCs

What are typical China strategies of chemical MNCs? What is the outcome of the analysis and the subsequent development and selection of strategic options?

In their published strategies for China, a number of chemical MNCs emphasise localisation:

- BASF claims that "local innovation and local production are driving business growth in this region". As a consequence, BASF is to increase local production to 70 per cent;
- Bayer aims to "grow in step with China's economic and social development";
- DSM focuses on the internationalisation of its asset base and workforce to create a better balance between sales by origin and sales by destination. China is specifically mentioned for its rapid sales growth;
- DuPont counts growth in emerging markets among its four main strategic trends;

- Dow China's president states that "our development in China is in the third stage, which is to build full local capabilities and capacities".

On the level of business strategies, this is reflected in activities such as

- Establishment of or increase in local production
- Hiring and training of local management
- Acquisition of local companies
- Increased share of direct distribution
- Increased presence in technical service
- Higher degree of local sourcing
- Increased local R&D activities

Localisation thus is indicated by one or more of these activities – it does not necessarily include local production.

However, some critical words with regard to the China strategy are necessary. The last decade has seen a strong shift in power from regional reporting lines to reporting lines along business units. While this development potentially increased synergies inside businesses, it also decreased them within a region. As a consequence, if a chemical MNC has ten different business units operating in China, it may in some way be more appropriate to think of this company as having ten different China strategies rather than just one. Of course, there are organisational elements such as the position of a "country head China" that are aimed at providing countrywide consistency. But the real power of this position depends strongly on the individual company and may range from a real power-broker to primarily a caretaker and representational function.

Avoiding Limitations: Strategies of Chinese Chemicals Companies

By contrast, published strategies of Chinese companies tend to be less specific than those of MNCs. Possibly this is a consequence of the unwillingness of these companies to limit themselves in grasping unexpected market opportunities, though it is likely also related to the lower perception of a company having specific core competencies (as discussed above). For example:

- Shanghai Huayi focuses primarily on growth targets, without going into specifics: "The main businesses shall be given highlighted importance with a reasonable planning and layout…Huayi Group shall make every effort in building itself into a world-advanced and China-renowned chemical group."
- Sinochem's Industrial Service Strategy, which it also calls "One-Two-Three-Four-Five Strategy", is similarly non-restricting with its five components:
  - "One ability" – Sustainability
  - "Two fundamentals" – Internal management/external expansion
  - "Three joints – Resources/technology/market
  - "Four measures" – Innovation/integration/mergers and acquisitions/collaboration
  - "Five key areas" – Energy/agriculture/chemicals/finance/real estate.

Consequently, the business activities of Chinese chemical companies are much harder to put into a strategic framework. Instead, decisions are driven much more by opportunities in the market (eg, a high price for a specific chemical leading to many Chinese companies extending production capacity) or government influence (eg, the rush into coal chemistry by Chinese companies). This is despite the claim of most Chinese chemicals to indeed have a strategy – a claim that is more likely to arise from the demands of shareholders than from the desire to provide a guideline for the company.

The Little Differences

MNCs and domestic chemical companies differ in their approach to strategy development. While MNCs tend to have somewhat consistent business strategies based both on internal capabilities and the external situation, local companies focus much more on market opportunities and overall are less limited by strategic decisions. While this may to some extent be the result of cultural differences, it can also be explained at least partly by the specifics of Chinese companies such as the combination of good market knowledge and less clear-cut core competencies. It should also be noted that for MNCs, provision of a published strategy is almost mandatory as shareholders seem to expect it. By contrast, expectations are lower for Chinese companies. Interestingly, though, Chinese chemical companies tend to also publish strategies, though their actual content is limited. It seems that the Chinese companies have understood the semblance of professionalism that such a strategy can give a company, while at the same time they avoid letting themselves be limited by it. ■

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Profile

Dr. Kai Pflug is the CEO of Management Consulting – Chemicals, a management consultancy specialising in the chemical industry in China. After obtaining a Ph.D. in chemistry and a master in economics, Dr. Pflug first worked as an R&D chemist for five years before moving into management consulting. In the last ten years, he has helped many major chemical companies while working for a number of consulting companies, including Arthur D. Little. For the last seven years he has been based in Shanghai, first as the Chief Representative of a niche consultancy, and now as the head of his own company, Management Consulting – Chemicals. The company offers consulting experience in Chemicals in China, provided in a flexible and reasonably-priced way, to many multinational and domestic chemical companies.

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