

# Finance on the Front Lines: Communicating the financial impact of front end execution will help chemical companies rebound

## Quick feet in the face of change

Recent events have presented a new and difficult learning curve for the chemical sector. The shape of world markets changed in a business heartbeat, bringing into focus realities and reactions never before seen on such a broad and damaging scale. It began with exaggerated volatility in oil prices that influenced radical shifts in energy, automotive, construction, and electronics markets, all of which saw a negative demand trend of historic proportions.

## Collapsed demand flow

For the chemical world, this translated into a demand flow that collapsed and resulted in inventory write downs in the millions of dollars. Companies large and small were forced to rethink supply, pricing, and to idle plants across the globe.

As the slumping industry struggles to emerge stronger on the other side, one of the lessons that has crystallized is that those on the front lines need to react as quickly as the market – or their individual company – shifts direction. Such quick feet in the face of change requires instincts, trust, and a thorough understanding of the business scenario that surrounds them.

There has always been a language barrier of sorts between the front lines and the finance office, even in organizations that stress a cooperative bond across the enterprise. Closing that gap means enabling every employee with information about how their day to day activities impact the bottom line, and how market fluctuations may impact their production and responsibilities.

By infusing the workforce with that connection, companies can benefit from faster front line buy-in when it comes to requests from upper management. In an environment that can see oil prices leap in a six-month span from \$60 per barrel to \$140 and back down to \$40, the full scale of organizations should be ready to adapt – or, more accurately, ready to change.

## Current dramatic environment requires rapid adjustment

The need for this readiness is magnified in the chemical sector. The financial fallout of the global economic crisis has not only hurt demand, it has struck transportation costs, supplier relationships, and consolidation trends. A surge in private equity investments over the last decade has in many cases brought with it a strong cash-intensive focus, often a philosophical change that must be filtered through the organization as management adapts to the strategy of its new owners.

In addition, the industry is faced with increased regulation as the United States considers adopting guidelines similar to those applied by the European Union's REACH. Such revised standards will impact the registration of chemicals, and compliance will require rigorous corporate efforts both structurally and financially.

## Volatile Market Dynamics

The economic crises led to a sharp downturn in the U.S. during Q4 2008, followed by a similar slide in Europe in early 2009. Even with a modest uptick expected in the global economy, the chemical sector is expected to remain weak. According to a recent report in Chemical Week, “The economy is expected to rebound, growing by 1.6% in 2010 and 3.2% in 2011, [but] major end-use markets for chemistry remain depressed... Basic chemicals are expected to face the most volatile variation, and bulk petrochemicals are expected to see a 14.7% year-on-year output decline in the U.S.”<sup>1</sup>

The various challenges sparked the largest number of chemical-industry bankruptcies in almost a decade. As of Q2 2009, six companies have gone bankrupt in six months, four have executed or are negotiating distressed exchanges, and another six are severely stressed.<sup>2</sup>

Nearly every chemical company has felt the pressure, with some being forced into dire straits and some taking swift action:

- The New York Times reported that German-based BASF stopped or slowed production at 180 plants around the world as it adjusted to a “massive decline in demand” brought by the economic turmoil. The article cites Peter Spengler, an industry analyst, as noting that “there is currently no demand for chemical products. The customer base is almost nonexistent in the fourth quarter because of inventory drawdown.”<sup>3</sup>
- Netherlands-headquartered DSM took pre-emptive action, stating in references to its 2008 year-end results that the company responded quickly to early warnings of a broad economic plunge. “The first action was to prioritize cash over short-term profitability via inventory reduction through plant shutdowns, reduced purchasing spend, focused credit control and the postponement of some projects. In doing so, DSM has been able to maintain its strong balance sheet and limit its dependency on the financial system.”<sup>4</sup>
- Dow Chemicals also highlighted the need for rapid response in its Q4 2008 Earnings Statement. “With a global economic crisis unfolding during the quarter, we responded with speed and urgency to get ahead of the demand destruction...We immediately put in place a full array of aggressive cash generation and cost and capital control measures that delivered results,” Andrew Liveris, chairman and CEO, said in a statement. “Most of our value chains are running at very low inventory levels, and when a recovery begins, possibly through government stimuli in the back half of the year, the recovery could be rapid.”<sup>5</sup>

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1 ACC’s Economic Outlook for the Week Ended June 26, 2009, Chemical Week, June 30, 2009

2 Moody’s: North American and EMEA Chemicals Outlook Negative, Moody’s Investors Services Press Release, May 21, 2009

3 Chemical Maker Cuts Output Amid Downturn, David Jolly, New York Times, November 19, 2008

4 DSM Reports Record Year Despite Global Economic Downturn in Q4, NPI Center, February 18, 2009

5 Dow Fourth Quarter 2008 Earnings Statement

## Making the adjustment

However common it may be for analysts and management teams to turn such financial outlooks into corporate approach, that sense of quick direction in the marketplace needs to be shared closely with the front lines of the operation. Indeed, as Liveris notes, “when a recovery begins it could be rapid;” the situation may lead to a turnabout in production strategy with immediate results needed from the plant floor. Expecting the front lines to adopt new tactics without understanding the financial implications invites a misfire that few companies can afford in the current environment.

Aligning finance with front end drives financial acumen and responsibility into day to day execution of the organization, which engenders the entire organization with the understanding that waste and inefficiency have real financial consequences.

Making this leap comes down to change management, a process whose success rests with communication, measurement and accountability. Findings from a 2008 study on change management conducted by the Economist Intelligence Unit and Celerant Consulting showed that failure to adopt change frequently comes down to “winning over the hearts and minds of employees at all levels of the organization... The difficulty is not intransigence: everyone interviewed for the study agreed that employees are willing to be won over. It is how this is done.”<sup>1</sup>

Companies can approach the “winning of hearts and minds” by taking a few key steps that promote buy-in and foster a sense of unity from the shop floor to the boardroom.

### Articulate a vision

Drafting and disseminating a clearly articulated vision are the first steps to harnessing the enthusiasm of the workforce. Executives should draft a statement that communicates the urgency of the situation, the financial ramifications, the need for change, and how it will impact the company. That statement should be filtered into all communications via corporate emails, town hall meetings, and everyday interaction from the ground floor to the boardroom.

### Share ownership, establish financial Key Performance Indicators (KPIs)

Fostering a sense of ownership is crucial to the adoption of change throughout a company. Teams perform best and take a personal stake in the outcome when they are given the opportunity to craft the strategy themselves – and when they understand the goals they are tasked with meeting.

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<sup>1</sup> A change for the better Steps for successful business transformation, Economist Intelligence Unit and Celerant Consulting, May 2008

Executives and managers should assign a tangible goal or Key Performance Indicator (KPI) that puts the financial impact of their duties into perspective. For example, when demand is expected to slow in the near-term, controlled ramp-up goals can be framed in the context of the financial impact to the company. Performance can be gauged on average and translated into dollar values that drive home the idea that work at the front lines has profound impact on the success of the business.

With KPIs outlined, front line teams should also enjoy autonomy to investigate the best path to reach them. This approach spreads risk, intellectual investment, and ultimately confidence in the process. And by design it encourages teams to test their theories and discover what works and what needs redirection. As Ralph Hargrow, global chief people officer at Molson Coors, noted in the EIU study, “People like to win, to know they are making progress. Lay out a detailed map, then measure the milestones and celebrate forward motion.”

## **Monitor and communicate progress to encourage ongoing buy-in**

Results and ownership are extremely effective motivators, especially across concentric circles of team players. However, the rest of the organization must also be kept up to speed on how the vision is being achieved. According to the EIU study noted above, 19% of survey respondents identified poor communication as the reason for failure of a specific program and 18% noted employee resistance, which is intrinsically related to communication.

Keeping a close eye on results is the first step of this effort. An executive steering team should be established to review progress and break down barriers for teams on a monthly basis. In addition, a project management team should meet weekly to measure results of the change program and report to the steering committee. Their findings and the company’s progress should be regularly reported from the beginning of initiatives via internal newsletters, emails, Town Halls, conference calls, and bulletin board material that displays quantifiable goals and illustrative charts and graphs. In addition to being information conduits, these vehicles provide a platform to personalize the process by identifying teams, names and faces.

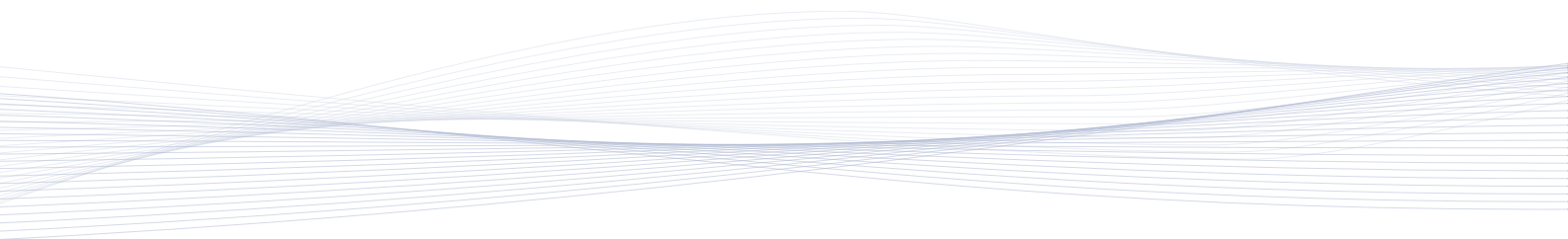
## **Positioning for upside**

Getting finance and the front lines on the same page could well be a critical factor in returning to a position of confidence in the coming years. Beyond the clear challenge of the economy, there will also be tremendous opportunities for chemical manufacturers that prepare for the next incarnation of the industry.

Climate change and carbon policy, for example, will be a significant business driver; having the workforce ready and well-informed about tackling that change could be a key factor for success. As the Wall Street Journal reported, “With legislation pending in Congress that could put a

price on greenhouse-gas emissions, the energy-gulping chemical industry is trying to position itself to emerge as an unlikely winner...a so-called cap-and-trade system would also boost demand for some chemical companies' products, from insulation to solar-panel components, because those products would help others cut back on the energy use.”<sup>1</sup>

Wherever the opportunity for improvement lies, the chemical industry must follow through on the shift to a model of greater transparency. Its ties to market trends have been exposed in historic fashion, bringing to light the need for full understanding of how each piece of the organization contributes to financial momentum in either direction. Speed to change is speed to value, and offering a window into that equation will strengthen chemical companies from the inside out.



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<sup>1</sup> Chemical Makers Poised to Gain In New Cap-and-Trade System, Ana Campoy, Wall Street Journal, June 5, 2009