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Business Process Outsourcing: Will Chemical Companies Go Offshore?

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Developing offshore strategies is one of the hottest topics in business. A quick scan of the latest business headlines gives the impression that everyone is either going offshore or is in the planning stages of going offshore. From basic IT (information technology) functions in India to leading-edge R&D in China, the global reach of company operations seems to know no national boundaries. Although sending business functions offshore has been common practice in manufacturing industries for decades, in the past few years a wider range of industries has begun launching offshore strategies as well. There are two major catalysts for this new interest in going offshore: improved international telecommunications infrastructures and lower professional labor costs. The result is that companies are increasingly pushing the boundaries and are reaping significant benefits in outsourcing their business processes to other countries.

But is the grass always greener on the other side of the fence? Executives in the chemical industry are asking this question. Strategies that work well for other industries, do not necessarily apply to chemical companies, which have a long history of favoring caution over risk. But such reticence is beginning to take its toll. In a speech given to industry executives in early 2003, Andrew Liveris, since appointed president and chief operating officer at Dow Chemical Company, offered these frank words. "Investors view our industry as stagnant, low-growth, low-innovation, and irrelevant to their investment dollars. While none of us likes this perception, we can't argue that it's undeserved. The chemical industry has not been making money." And while he maintained that outsourcing and offshore strategies have not yet delivered their full potential, he argues that they will be critical in turning the industry around.

To gain deeper insight into the offshore practices of companies in the chemicals industry, A.T. Kearney recently conducted a market survey. Surveys were sent to a select group of executives, including the five largest independently traded US chemical companies. Surveys were also sent to executives at companies in other sectors of the chemical industry, including ink, adhesives and agriculture as well as chemical process technology licensors.

The key finding from the study underscores how much the chemical industry is lagging well behind others in terms of capturing benefits from going offshore. Just 20 percent of chemical companies realize more than 30 percent cost savings from their offshore strategies; in contrast, roughly 40 percent

What Countries Are Doing Your Offshore Projects?

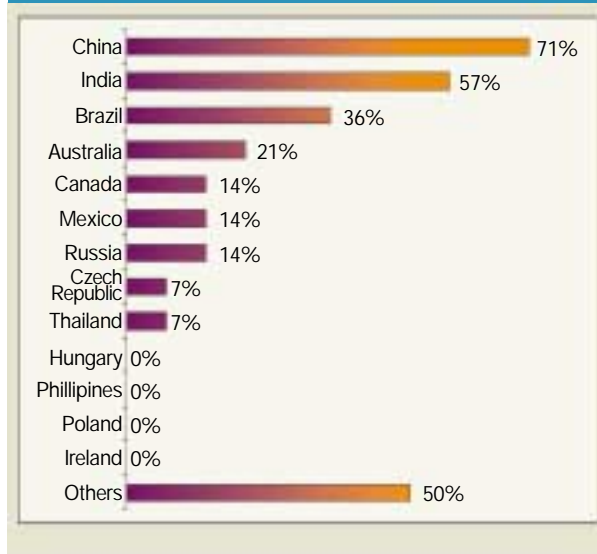


Figure 1

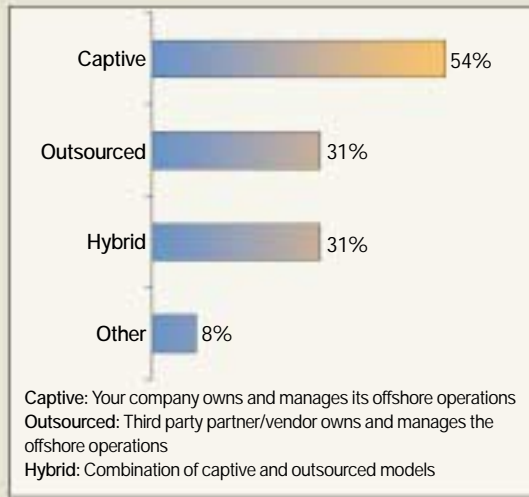
of financial institutions and automotive companies reap similar savings (see related sidebar).

Where Companies Are Going

The gap in offshore strategy between the chemical industry and other industries belies the fact that chemical companies were among the first to break through international boundaries. In the 1980s, chemical companies entered China for the first time through joint ventures and alliances with Chinese companies to build plants. In the years since, companies have simply leveraged existing joint ventures and alliances to conduct offshore work.

This is why, as our study reveals, more than 70 percent of executives in our survey have offshore functions in China, topping India (57 percent) and Brazil (36 percent)—countries that are generally the preferred offshore locations of choice for other industries (Figure 1). For chemical companies, China has maintained a distinct lead over other countries in terms of offshore

What is the Structure of Your Current Offshore Operation?



Source: A.T. Kearney

What Kind of Partners Are You Using for Your Offshore Activities?

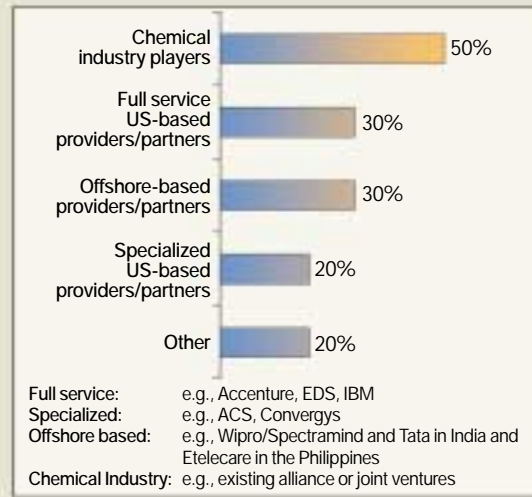


Figure 2

attractiveness, in part because many already have offices and manufacturing presence there. Although, in some cases, companies are choosing to use a third-party provider for their IT support services to leverage the scale of large service providers in India.

The commitment to these markets also seems to be on the rise. After failing to meet its annual growth target for 2003, DuPont announced it planned to accelerate the shift of facilities and staff to emerging markets, including Eastern Europe and Asia. DuPont's chairman and CEO, Charles Holliday, explained that he is moving DuPont's "center of gravity" to countries such as China, which posted a 30 percent improvement in revenue. Building on its long-standing history in China, for example, DuPont plans to source less expensive raw materials in Shanghai, which is expected to save the company \$200 million.

And How Companies Are Going

This established presence in China also translates into the fact that rather than outsourcing their business process to third-party vendors, most companies (54 percent) favor owning and managing their offshore functions (Figure 2).

As part of a do-it-yourself industry, chemical companies tend to be reluctant to look to third-party service providers to manage the various functions in the offshore location. When companies use these providers, they lower the benefits they would otherwise receive from going it alone, but the risk decreases proportionally as well. As companies begin to see the benefits of using third-party providers, and gain experience, they may ultimately choose to take back control of the processes.

Also, in having established a footprint in other countries through captive facilities, (those that are wholly owned by the company) or through joint-ventures, many chemical companies argue that they know the lay of the land better than most

third-party service providers. However, while third-party providers may not know the country as well or have the same history there, most have a deeper expertise in certain functional areas and are better equipped to take a function offshore. For chemical companies, this means a third-party can often take them further and faster than what they could do on their own.

Bottom Line

The bottom-line benefits from offshoring are significant for a chemical company. For example, the back-of-fice support function that includes finance, accounting, procurement, internal help desks, logistics and distribution, and customer service centers can amount to 1 to 2 percent of revenues for a chemical company. For a \$5 billion company, this represents \$50 million to \$100 million in cost savings. With 50 percent of the back-office support functions sent offshore, applying a savings of 30 percent can yield \$8 million to \$15 million.

The opportunity is far more significant when it comes to R&D given that R&D can be 4 to 6 percent of revenues for a chemical company. Again, if 50 percent of the R&D spend can go offshore, then the savings for a \$5 billion company can add another \$30 million to \$45 million in savings (based on 30 percent cost savings). Total support services and R&D offshoring can yield from 0.8 to 1.2 percent savings as a percent of sales.

Using ROCE (return on capital employed), implementing an offshore strategy can potentially yield 80 to 120 basis points improvement. For the chemical industry, this can translate into roughly a 10 percent improvement in overall ROCE.

BPO at Work

While the research is informative, more insights can be gleaned by looking at the offshore experiences of specific

companies within the chemical industry. Consider two leaders, Rhodia and DuPont. Rhodia, headquartered in France, achieved nearly 40 percent savings (\$6 million per year) by sending its basic accounting functions offshore. With its finance staff spread across 60 sites throughout Europe, Rhodia first decided to cut costs by consolidating its finance and accounting processes into a single shared services center. It then opted to relocate this function to the Czech Republic, which featured a well-educated workforce, a shared time zone and a solid communications infrastructure.

In working through the process, Rhodia learned several important lessons. First, project managers that focus cultural aspects of the offshore strategy should be involved early on. Also, projects should roll out slowly, with an emphasis on planning how the services will be delivered. Finally, the transition period should be as seamless as possible. Customers should see no discernable difference between employees who work within the company and those who are part of the offshore location.

DuPont is an offshore pioneer. Just five years ago, all of DuPont's engineering work was performed domestically. Today, 50 percent of its production engineering and design are conducted offshore. DuPont's contractors use low-cost centers in countries such as India, the Philippines and China for their production engineering work. In one example, DuPont claimed a savings of \$4 million when an entire engineering

design for a non-woven fabrics plant was completed in India. And in the process, it has exceeded quality targets and savings through higher utilization rates through its offshore strategies.

Beyond back-office support functions, many chemical companies are sending their basic R&D and engineering processes offshore as well, which represent a high percentage of chemical companies' total costs. Interestingly, our findings reveal that chemical companies offshore R&D and engineering activities at similar levels that other industries offshore their financial and accounting services. This may indicate the maturity level for companies that have sent their R&D offshore. Chemical companies have been able to successfully offshore more complex functions compared to other industries. These R&D activities include design and process documentation, product development, and pilot plant manufacturing simulation.

Going Forward

If chemical industry executives begin an offshore discussion by asking the question, "Do we need to go offshore tomorrow in order to stay in business?" The answer, by and large, will be no. A better question to ask is: "Can we gain a competitive edge in this low-margin industry?" With proper execution, the answer is yes. And when the leaders begin taking the first steps, others had better be ready to follow.

In planning their offshore strategies, chemical companies may want to take a page from the automotive and financial institutions industries. Companies in both of these industries began by exploring offshore strategies for functions such as finance, accounting, engineering and technical services. By

Market Survey Results

The study findings reveal that chemical companies primarily send the following activities offshore (Figure 3, below):

- Procurement, logistics and distribution, internal help desks
- Engineering, R&D, technical services
- Finance and accounting services

In comparison, financial institutions mainly send the following activities offshore:

- Transaction processing
- Analytical and technical services
- Customer service
- Finance and accounting

Automotive companies mostly send the following activities offshore:

- Engineering and technical services
- IT (application development and maintenance)
- Finance and accounting services

What Type of Activities Are You Currently Conducting Offshore?



Source: A.T. Kearney

What Types of Activities Do You Plan to Offshore Next?



Figure 3

increasing their offshore presence in these areas, chemical companies will do what the automakers have done—increase their potential to consistently extract higher cost savings.

The process of evaluating the best offshore strategy, one that is aligned to meet the unique needs of your business, begins with a review of several factors. First, evaluate which functions are potential candidates for going offshore and estimate the potential savings. Which are critical and which can be outsourced? For those functions that can be sent offshore, it is important to have well developed and clearly defined processes. DuPont has taken a unique approach by running concurrent tests—taking various processes, handing over some to third-party service providers and managing others on its own. If a company is large enough and has the funds to invest in this approach, it is worth considering. Another key strategy is to pinpoint one or two areas to develop, and create a long-term strategy for them.

The next step is to design a business model that will maximize savings while addressing any customer and data sensitivities, as well as intellectual property concerns. The model should consider several types of partnerships, and include an evaluation of the best location. It should also identify the qualified providers that would perform the functions. If a function requires a captive structure, a cost-benefit analysis will reveal the necessary investment in facilities, people and infrastructure.

Finally, it will be necessary to consider the various implementation strategies. Companies that want to minimize their risks will take a pilot approach—testing, learn, and making adjustments to their offshore activities before rolling them out on a larger scale. Risk-averse companies map out the roles and responsibilities, for both the parent company and offshore unit, to ensure accountability. And it is important to establish key milestones and performance metrics to help track the progress and monitor the results.

Looking Ahead

How long will it take chemical companies to become proficient at offshore? The answer is not clear. In most cases, in mature outsourcing areas such as IT, the returns can be realized anywhere from six to nine months. Other areas may take longer


depending on the function that is going offshore and how well it is being run in-house.

Regardless of when an offshore strategy is implemented, or how soon results are obtained, our study findings reveal three key elements of every successful strategy in the chemical industry as outlined below.

- Offshore is one element in a larger business plan. Senior executives who are interested in increasing their ROCE by 15 to 20 percent will consider using offshore as one plank in their action plans.

- The top companies mitigate risk. Senior executives who are concerned about the risks of moving operations offshore, mitigate the risk by using a third-party provider or by taking a pilot approach to offshore. They also have a recovery plan in the event that unforeseen circumstances force them to move the operation back onshore.

- Moving offshore is part of a larger effort to streamline and standardize operations. Top companies do not simply move the operation to a lower labor cost market, they first streamline and standardize their operations. This is especially true for companies using a third-party provider to avoid handing over their benefits to a third party.

Today, offshore service providers are rapidly maturing, while the industry's level of experience is moving at a slower pace. Thus, the primary factor on the use of offshore is, and will continue to be, the insights and abilities of executives who are charged with making offshore decisions within their own companies. 

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