



STRATLEY
A KPMG entity



GLOBAL RULES OF COMPETITIVENESS EMBRACE GCC CHEMICALS

Competitiveness in times of levelling differentiators

Released on the occasion of 11th Annual GPCA Forum in 2016





CONTENT

Recent developments in the Middle East and GCC	4
The growth curse	5
Business models as navigator	9
Business models as “guide rail” for competitive differentiation in MEA/GCC chemicals	12
Conclusion	17

Globally, chemicals companies' growth will be less and less nurtured by breakthrough product innovation. M&A is becoming an alternative to fill this gap. This global phenomenon coincides with diminishing availability of local feedstock in the MEA/GCC and a melting advantage of it, compared to other regions. Margins are also under pressure from lower prices due to lower oil prices. These challenges trigger MEA/GCC players to rethink their global competitiveness and future strategic positioning. Analyses along dedicated business models can help find the right directions. The respective measures will ultimately make them better companies reaching a next level of professionalism and globalization. We already observe a convergence of the global chemicals industry, where competitiveness is now a matter of mastering a larger number of disciplines rather than only a few.

1. Recent developments in the Middle East and GCC

Until recently, Middle East (MEA) chemicals companies, especially those in the Gulf Cooperation Council state, were in their own league of competitiveness and of what is needed to achieve it.

Significantly, advantaged feedstock running through world-scale plants with state-of-the-art technology was the formula, which successfully added to the world a number of highly competitive chemicals hub in the Middle East. All that was based on a consequent exploitation of the beneficial economics of what was previously flared as an unwelcome by-product of oil production (associated gas, e.g. in Saudi Arabia) or simply available in the ground (NGL, e.g. in Qatar). The combination with a strong management focus on seeking access to technologies to keep additional steps of the value chain in the countries paid-off and paved the way for one of the most astonishing success stories of economic and industrial development. Hence contributing to the governments' agendas of creating jobs and diversifying the economies.

In the future, this will not be enough anymore to ensure competitiveness, due to the synchronism of a growing number of challenging factors:

US shale developments since the beginning of this decade alone would require an adjustment of competitiveness logics in the region. But since then, additional pressures arose from limited availability of local feedstock for new projects combined with an increase of cost for the advantaged feedstock/utilities in general. Low oil prices benefit naphtha-based production mainly in Europe and Asia and could at best slow-down, but not eliminate US shale activities. In contrary, parts of existing shale-based outputs in North America are expected to be offered to Asia, where especially China's economy is below expected growth levels.

Is it too much of a snap-reading method? No. While of course parameters such as oil price and growth of countries vary and constantly impact any region's competitiveness to the worse or better, the structural change cannot be denied. When comparing to a world with abundance of cheap feedstock in the region, rapidly growing emerging economies and old and withdrawing production assets in the West – as was the case in the "Golden" 1990s and 2000s – the old recipes do not work any longer.

Is it too grim of a picture? Not at all. Rather a normalization and integration of MEA/GCC players into the globally applicable rules of competitiveness in the chemicals industry. A challenge and chance at the same time and a strong force towards the next steps in the region's maturity process towards a professional and competitive set-up overall. With the need of addressing now key competitive differentiators, formerly being treated as lower-priority and one was able to get away with it.

Not anymore. It can be expected, that a lot of attention will be directed to the following success factors, of which all can make a difference when comparing to the peers:

- » Strategy development: a paradigm change away from a volume and domestic feedstock-based one towards a more holistic and global approach
- » Customizing the role of innovation to decrease the gap towards state-of-the-art innovation as a rather slowly moving target
- » Mastering marketing and sales excellence to stop eroding margins and back-compensate
- » Addressing organizational set-ups typical for MEA/GCC chemicals companies

As all this is leading to MEA/GCC chemicals companies being more and more a natural part of the global tectonics of the industry, we want to continue discussing competitiveness from a truly global perspective, while indicating regional peculiarities where necessary.

We will do this along the main question: How can executives of chemicals companies ensure to grow their companies and businesses competitively in future?

2. The growth curse

While many Middle Eastern executives have concerns about an erosion for their competitive advantage, most Western executives regularly have to answer investors' requests for constant and reliable growth which is causing conflict. An elderly and cyclical industry with an increasingly competitive landscape leaves only few options along innovation, organic or external growth.

Innovation – no fundamental inventions for about 20 years

Back in the 1860s, inventions gave birth to the chemicals industry and it were inventions that made it grow. What started with dyestuffs was followed by fibres, plastics, pharmaceuticals and many others. There was plenty of room to build and grow companies. But the chemicals' innovation stream came to a halt in the 90ies of the previous century (Figure 1).

This happened at a time when chemicals and pharmaceuticals became increasingly separated industries and crop science started developing into more of a sister of pharmaceuticals than chemicals. And, thirdly, it was also around this time when chemical companies began to realize that growth was no longer guaranteed by products their large central research departments were churning out.

Organic growth – global competition significantly increased

Luckily enough, the chemical industry tends to supply materials for virtually every single aspect of human life – hence growth at no less than GDP rates is more or less given. This allows for decent organic growth paths. Therefore, the first and easiest option should always be to grow organically wherever and whenever possible. Markets are known as are industry dynamics, competitors as well as raw materials supply. This knowledge forms a sound basis for an educated decision.

However, because building a new plant often turns out to be a big investment, decision making overwhelmingly depends on good business prospects. The more so, since – at least with a listed company – the supervisory board has to be convinced as well. Therefore positive investment decisions tend to fall into times of prospering businesses with an overall positive mood both at the company and at the markets. Given that these decisions take a while to “mature” there is a high chance that a prospering business is already near the peak of the boom when the final affirmation

is given by the supervisory board. The result are capacities that start operation when the markets have turned sour. Even worse, since all listed companies act in the same way and potentially new entrants are blinded by the high revenues of the late boom phase quite often we see a glut of capacities coming simultaneously on-stream at the wrong time. And although this phenomenon has been discussed in economics for almost 100 years, due to ever increasing compliance regulation it seems very unlikely that supervisory boards will get more courageous and try to act counter cyclical. The comparatively short tenure of serving CEOs further contributes to the misery, making companies repeat mistakes in the next cyclical wave. Hence, continuously successful organic growth is restricted to areas with high entrance barriers, truly unique products or technologies and/or smaller scale investments.

Acquisitions – the last resort for fast growth

With the above dilemma for incumbents (little to no innovation, limited/cyclical organic growth options and organic growth taking years to convert into money) they have to pursue acquisitions. But which ones?

Basically there are two types (sometimes combined)*

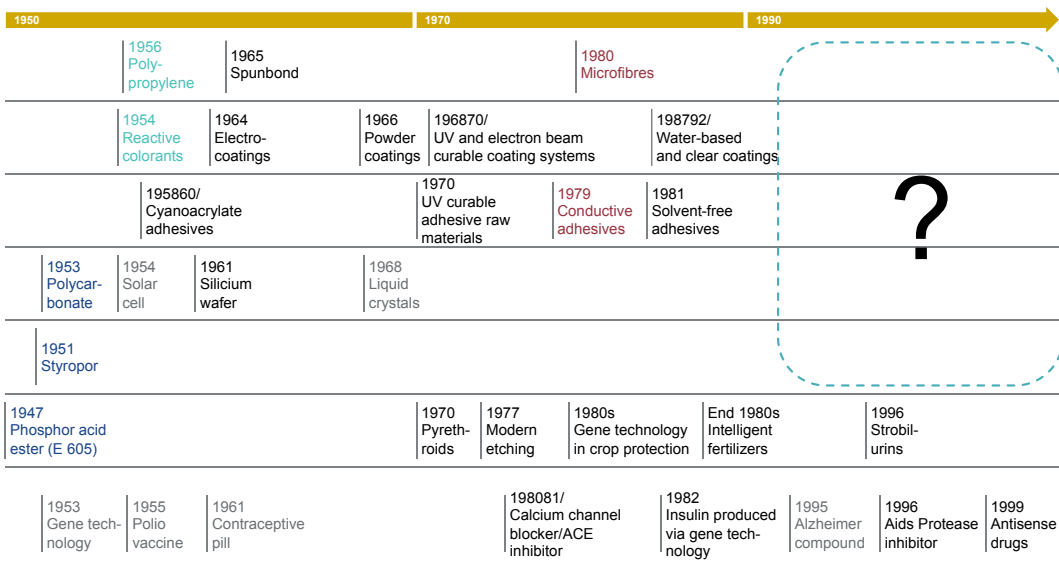
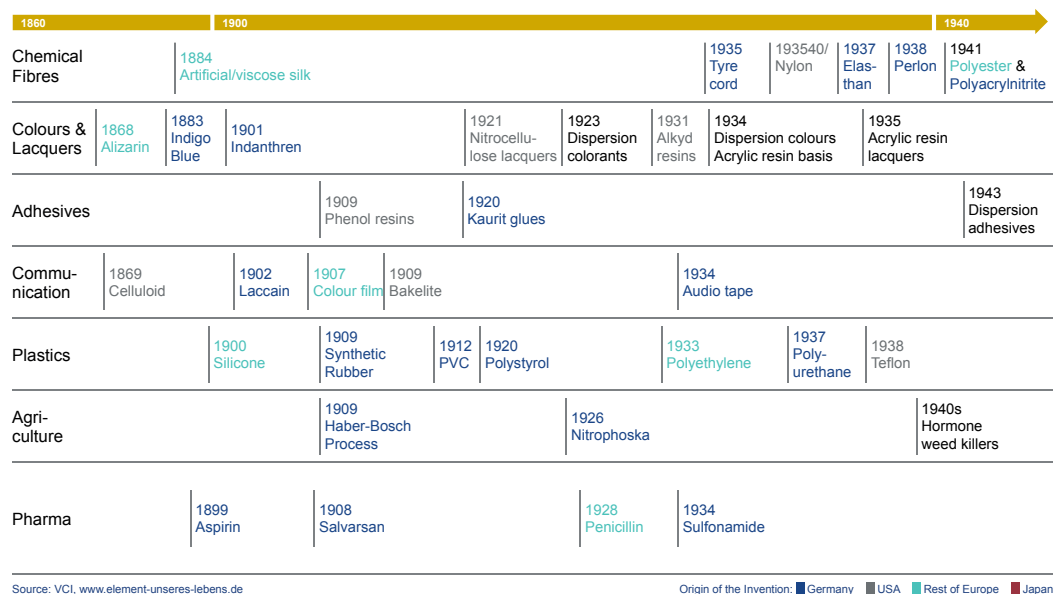
- » Consolidation acquisitions (small, large)
- » Venture into new areas (small, large)

In theory, consolidation is a relatively easy undertaking since – similar to organic growth – the main market and industry facts are known. In contrast venturing into new areas appears to be quite risky since decision making has to rely on information that can only be judged upon incompletely. Then again consolidating existing businesses usually costs a lot of money with little overall growth potential whereas new areas run the danger of being misleadingly seen as “the promised land” with easier business environments and higher margins.

Perhaps this has to do with the inherently limited understanding of a new area. To make matters even more complicated, small acquisitions are easier to “digest” than larger ones but do require almost the same effort.

** One might argue, that there is another class: acquisitions of “adjacent” businesses. Depending on the closeness to the original business we put them in either category. Size wise they are usually of the smaller type.*

Figure 1: Major innovations in chemicals over time



In reality we could witness two different acquisition strategies – one going for more risk and being more “visionary”, the other one strongly emphasizing financials and limiting risk.

Whereas the former repeatedly ended in huge write-offs, the latter one often results in doing nothing.

Acquisitions – current developments

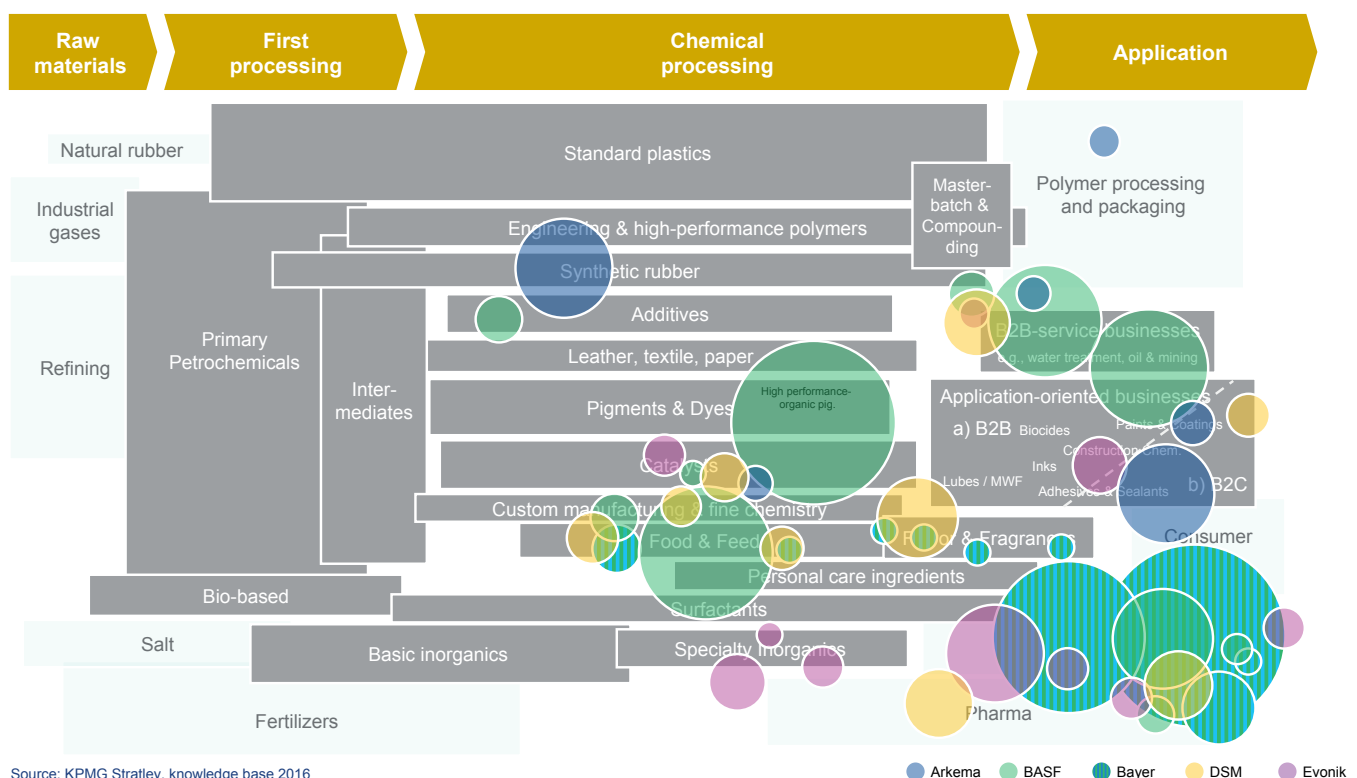
Looking at different chemical companies’ acquisition choices, there seems to be a movement from the left (basic materials) to the right (close-to-the-end-market products) of the chemical value chain (Figure 2).

The likely rationale behind it: products close to the end markets tend to be less volatile/cyclical and are generally understood as allowing for higher margins. In addition, there is a greater

chance that products further down the value chain are “younger” than the ones on the left – giving more breathing time until full commoditization.

The consequence of many players looking to the right for acquisition opportunities are steadily increasing multiples for acquisitions – with a growing risk of never achieving the intended value creation. Having gone through several bad experiences in the first acquisition wave of the nineties, incumbents have now grown more cautious regarding large acquisitions. Their new focus is smaller prey. Since all companies are searching for similar smaller targets prices are already quite high again.

Figure 2: Chemicals value chain



Source: KPMG Stratley, knowledge base 2016



3. Business models as navigator

Given all the above developments, two critical questions remain.

- » How to keep competitiveness and grow competitively?
- » Which acquisition targets to aim at and which businesses to divest?

Surprisingly enough, there is one simple answer to both questions – creating clarity about the very nature of one's businesses (business model) and acting accordingly.

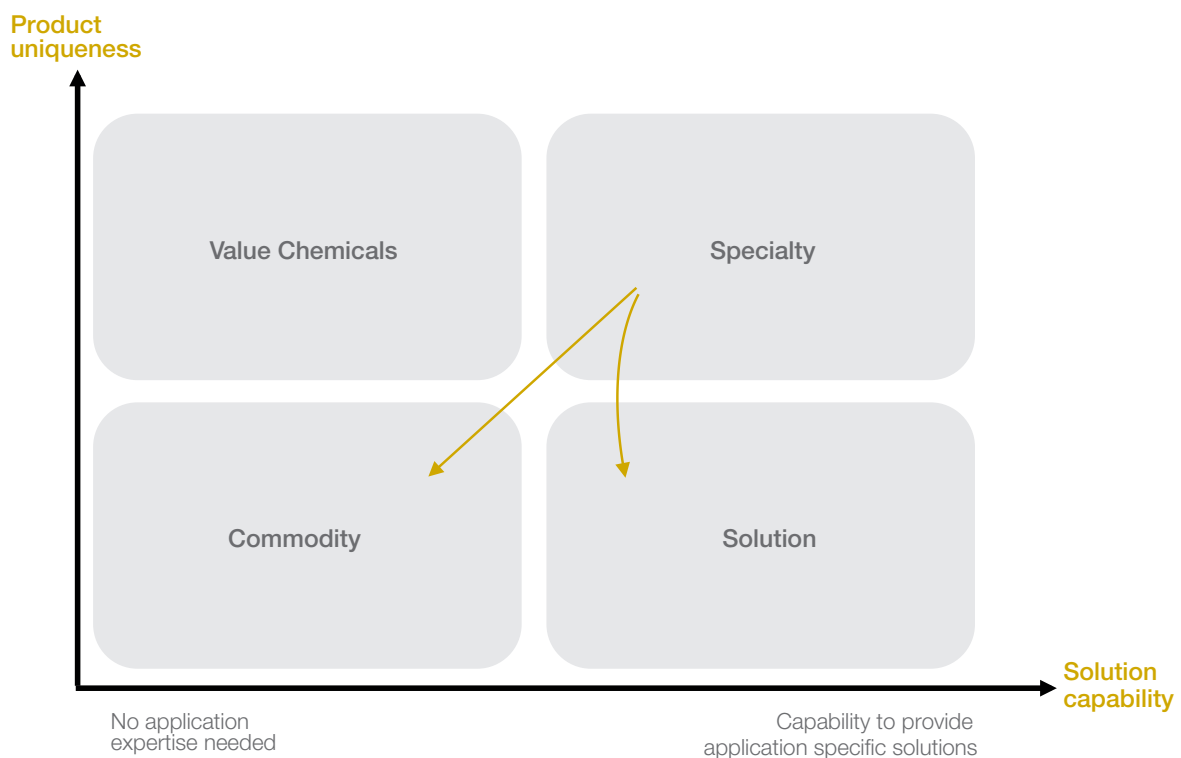
Business models

Every single business has some key success factors and certain needs – which initially are independent of how a business is run in reality. Our four quadrants matrix describes four distinct business models, with commodities, specialties and value chemicals (often called fine chemicals) being well known ones, and solutions as a more recent (separate) development (Figure 3).

Business models in our understanding clarify a company's approach towards the entire business – not just elements like customer relations, production excellence or raw materials supply. Whereas commodities clearly ask for low cost in terms of little overhead, large scale production, cheap raw materials etc., solutions do not require chemicals production at all – in fact it is the result of the use of chemicals that is sold, like cubic metres of treated wastewater or numbers of lacquered components. Hence, this business model builds on very specific application/technical knowhow to produce the desired outcome.

So, when thinking about competitiveness or a growth path for a business, the first step is to honestly define the very nature of one's business(es) and doing this independently of the current margins. In a second step the management should take a position on whether it can match these requirements. And if there are, e.g., commodities in the portfolio which require cheap feedstock and low overhead cost a high wage country with expensive raw materials might not be the right home any longer.

Figure 3: Business models in the chemicals industry



Source: KPMG Stratley



This sounds trivial but since almost every single product started as a specialty based on innovation, it was not the commodity environment that gave it industrial scale but the intellectual leadership of a country/region (for a moment leaving beside closed economies that were forced to build their own supplies). During its long way through the life cycle these requirements change (see arrows in figure 3) and the challenge for the companies running these businesses is to adapt.

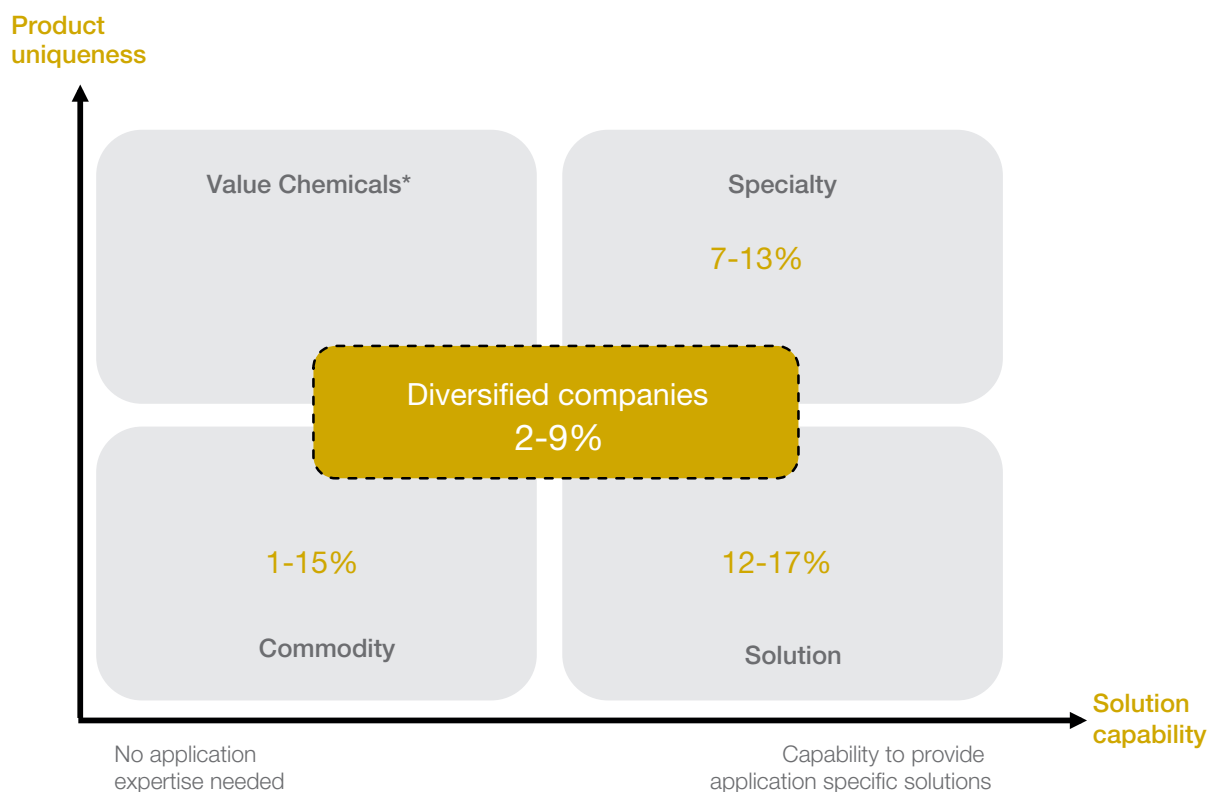
Target selection: Greater focus on business models

As shown above, companies looking for acquisitions usually focus on the right-hand side of the value chain with its younger, more

profitable and seemingly less problematic businesses. A “natural” reaction to the pressure of investors and analysts. However, in our opinion oversimplifying. For two reasons.

Firstly, a closer look at the margins/profitability reveals a picture different from intuitive expectation. Within any of the business models there are companies that make a decent profit and others that perform badly. So, it is not the business model per se that is driving profitability. The way the business is run according to its requirements drives success (Figure 4).

Figure 4: Total shareholder return (Ø 2006-2015 by business models)



* Too little pure play companies among the largest players
Source: KPMG-Stratley analysis, ICIS Chemicals Top 100 list (mostly based on the largest 50 players by revenues); Capital IQ, Thomson Reuters, Yahoo Finances



Secondly, if a successful business is bought into a completely different business model environment, it might lose its magic formula in a very short period of time. In case a commodity player takes over a specialty business it often makes it adopt to a new mentality – simply by introducing the existing processes. Commodity mentality is trained on avoiding complexity, caring more about capacity utilization than customers, providing little service etc. Thus, it is only a matter of months when customer satisfaction goes down and with it profitability. (A reverse problem could arise if a more specialized player is integrating backwards into a strict and lean business model.)

So, given all the above what are the lessons for external growth?

- » For all (listed) companies the pressure for growth will continue. Hence, they will go on searching for acquisition targets. As long as cheap money is around this will continue to drive prices up. In case companies have clearly analyzed their core strengths and acquire accordingly this still looks like a sensible way forward. For larger conglomerates it looks advisable to organize themselves along clearly separated business models. Businesses with the same business model should compete for capital expenditure/acquisition funds, should be managed by a dedicated board member/divisional head and should rotate staff within their business model driven part of the organization.
- » The focus on one business model could sharpen the view. Today there are few parties interested in the commodities businesses of the old names of the industry. Whenever a PVC, styrenics or similar business is on sale in Europe, many of the companies in search for growth refuse. However, privately owned players like INEOS (SK Capital to be watched) have shown that strictly concentrating on this field and managing the businesses accordingly provides fine results as well.
- » A different problem occurs with high margin but already focused businesses. They are “naturally” restricted in their growth – proportionally to their organic options getting smaller. Buying any other business will dilute their margin – to the dislike of investors. For them the tricky question is to find similarly attractive business areas where their core strengths will do the magic again.
- » The announced Dow/DuPont merger reminds of the Ciba/Sandoz/Hoechst reshuffling in the 90ies – resulting in Novartis, Clariant, Aventis, Celanese etc. Such moves clearly help to reshape the industry towards more focused players. However, to get transformations of this calibre going, there are big initial hurdles to overcome. Besides having similar problems in different companies which could be solved or diminished by the same solution (AgroChem with Dow/DuPont) the much bigger issue is who is going to call the shots after the merger. Therefore, either an advantageous age/career combination (of the CEOs) or the perspective of a subsequent split into a few new players might finally motivate a joint start of such a journey.
- » None of the above options might work for Western listed companies with strongly commoditized businesses. Raw materials and/or energies are much cheaper elsewhere, new world-scale plants are much more cost effective than the own older ones, main markets are closer to competitors, old hands of the industry advise newcomers how to improve output and quality, economic criteria are sometimes dwarfed by governmental interest. An almost endless list.

Businesses or companies that are no longer competitive in their respective business model arena(s) and do not have the money to buy dearly priced targets face a difficult future. At least as a publicly traded company. Since they cannot fulfil the respective growth expectations, their share prices will plunge and at some point an investor takes over. Although there might be different steps in such a process (e.g. forming joint ventures, selling to an emerging economies' buyer) finally the company is likely to be taken private.

4. Business models as “guide rail” for competitive differentiation in MEA/GCC chemicals

The above described fundamental regional and global trends are the harbingers of a new era. An era which will embrace MEA/GCC chemicals companies as rather “normal” participants in the global market. Regional peculiarities will remain to exist as they do in all other regions. E.g. feedstock prices will remain to be at the lower end or the strategic geographic positioning allowing for easy access to several export regions will remain competitive strengths. However, their lever won’t provide any longer a consistent competitive edge of the magnitudes seen in the past. Instead, MEA/GCC chemicals companies will become more and more subject to the global principles of success of their industry. This will lead to new shores, which in some cases will be challenging, in others however, opening up new opportunities. To prepare for the former and being able to seize the latter, we see four areas becoming of increasing relevance in the coming years:

Strategy development towards a targeted business model as the guiding force for future competitive growth

Strategy development in the past could be simply built on the availability of feedstock at low cost, mainly Ethane. This made a lot of sense as the cheap access to the main building blocks of petrochemicals led the foundations and pre-requisites of any further ambitions towards a more maturely developed downstream chemicals sector. Mastering base and as such mainly commodity chemicals was the necessary first step with – in most cases – determined pathways along the C1, C2 and C3 value chains with the C2 chain clearly dominating. It was mainly about setting a volume target attached with a deadline and the assigned product portfolio mainly driven by the next value chain steps and the access to the respective technologies. In the majority of cases, the technology partner was involved through JVs and, depending on the agreement, mainly taking care of marketing and sales of products. What then was an almost exclusive scenario of strategy implementation, can be seen today as only one among all other prevailing options. More and more M&A was embraced as an option of growth, latest after SABIC’s takeover of GE Plastics. Not least due to such acquisitions and international co-operations, finally, one can notice participation in technology development with remarkable successes. Take the α -SABLIN technology developed jointly by SABIC and Linde for the production of linear alpha olefins (LAO) as an example. All this hints at the variety of means of strategy implementation becoming wider.

What about strategy development in first place? Here, a paradigm change away from a purely domestic feedstock-driven commodity and volume target approach started to take place already a few years ago. But towards what and where? There is no longer one answer for the whole region. Too limited is availability of advantaged feedstock on the one hand and still too attractive is alternative feedstock such as Naphtha on the other hand. Saudi Aramco through SADARA is in the process of starting this era just now: more liquid feedstock with respective higher cost structures compared to Ethane crackers, but feed slates with much stronger contributions through by-products in the C3 and completely new options in the C4 value chains.

The higher complexity of strategy development for chemicals companies in MEA/GCC begins with the necessity to think about more raw material options. Including those which are still ideas, e.g. Saudi Aramco’s and SABIC’s joint efforts in oil-to-chemicals technologies, and those which are abroad, e.g. shale gas in the US or coal in China. A local-centric production approach will become more and more globalized, which adds a second complexity compared to the past. As a consequence, wider product portfolio options follow with all the respective needs for knowledge and skills.

MEA/GCC chemicals companies are in the process of normalization, i.e. facing similar challenges and opportunities as companies in the rest of the world. This requires individual answers to similar questions. The outcome of strategy development will have to put greater emphasis on the individual position of a company. Orientation through the thicket of options can be provided by asking what business model (see figure 5) can be best supported by the company’s prevailing positioning in key parameters such as feedstock, product portfolio, technologies, network partners, innovation and product development pipeline, stakeholders’ mindset, global reach, connectivity to potential end-user industries to just name a few important ones.

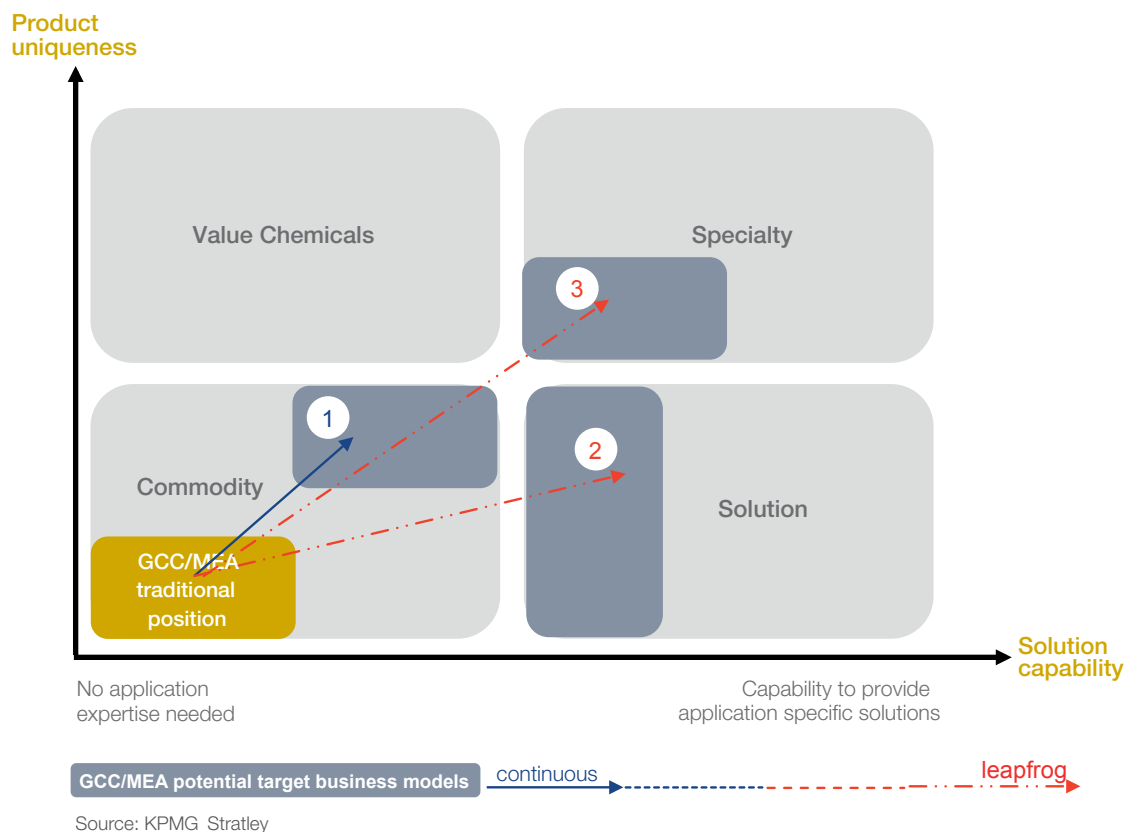
The earlier described global dynamics towards a repositioning of chemicals companies in the West come at the right time for MEA/GCC players. All the more so as in particular Western companies want to divest those parts of their portfolios which they consider as commoditized and where they see themselves as no longer well-positioned to support them.

From a MEA/GCC perspective some of these products mean a step further downstream with the respective challenges in know-

how and skill-sets. However, allowing for a rather gradual approach towards “specialities” as a business model option. From a global perspective this is a win-win situation: Western companies will clear their portfolios from businesses which they can no longer

sustain, whereas MEA/GCC companies are able to steer towards an enhanced commodity model in a next step.

Figure 5: Business models in the chemicals industry – MEA / GCC perspective towards “Specialties”



As a result, a business portfolio based on individual strengths along the value chain can be pursued with a clear view on future market requirements, regional and global megatrends.

In addition, mergers between companies within GCC countries are likely to be explored by leading GCC players. This potentially creates the critical mass to benefit from shared services, utilities and procurement as well as innovation efforts and people development, all being pre-requisites for global competitiveness.

Customizing the role of innovation to decrease the gap towards a slower moving target

Until the end of the last century, product and process innovation was the driving force of differentiation and perhaps the determining element of the rise and pertaining dominance of a chemical company. The consistent emergence of new products with life changing impacts on the consumer out of the same few labs mainly located in Europe, Japan and the US until the early eighties helped incumbents like BASF, Bayer, Dow or Hoechst to pull away from the rest of the world by keeping their status untouchable. While emerging followers might have been increasingly able to come closer in existing products the incumbents would draw from their pipeline to keep or even widen the gap again. The ceiling of product and process innovation seemed unlimited and as such the




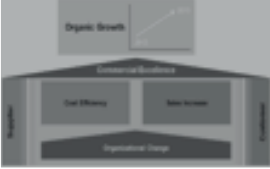
perspective for others to catch-up looked grim.

As the incremental achievements of product and process innovation became smaller and smaller, innovation is becoming a more holistic concept potentially addressing all corporate activities and being less clearly demarcated from efforts related to incremental improvements or operational excellence. This allows for emerging players to narrow the gap.

For most MEA/GCC chemicals companies, still being at the left hand side of the value chain (Figure 2) any move downstream will come with plentiful learning on products, processes, technologies and customer behavior. The latter becoming more and more relevant the further downstream the business. All these learnings will contribute to a mature level of innovation also in this region gradually narrowing the gap to the global innovators.

The opportunity for MEA/GCC chemicals companies is to establish such a holistic understanding of innovation, beyond R&D only, to weave it early on in its corporate DNAs towards the creation of an innovative corporate culture that empowers individuals. Again, similar to strategy development, this is a very individual process leading to a customized role of innovation in all areas:

Figure 6: Categories of a holistic innovation view

Categories of innovation			Examples
	Product and its application	Physical S S S C	Improved chemical properties of a material
		Service S S S C	Customized material selection support
	Manufacturing process		S S C C C New synthesis route for chemical product which saves 30% of energy
	Business process		S S S C C C Improved human resource process to select better talents
	Business and operating model		S S S C C C Separate commodity business (besides specialty business)

Source: KPMG Stratley

C Commodity S Specialty

While incumbents from the West do struggle with structures and mind-sets inherited from former times, i.e. oversized labs and staff, emerging players are able to calibrate their innovation measures according to the requirements of the selected underlying business model (see Figure 6).

Mastering marketing and sales excellence to stop eroding margins and back-compensate

In a world of growing competition where stakes for innovation become higher, knowledge about customers, their real preferences as well as behaviour is becoming more important. This applies to all shown business models, however conclusions on measures and affordable efforts will differ.

Where products become interchangeable, good customer relationships and market understanding may lead to insights on how to differentiate through rather simple means, e.g. delivery from another location. But it might also lead to a deeper understanding on how to slow-down or halt the further commoditization of the customer relationship through the right set of supplementing services. Take plastics pipes as an end-user example: rather simple and easily comparable products. Offering them with a set of recurring services such as their laying and maintenance, may potentially lift commodities towards a solution. Understanding one's own role and opportunities along the value chain of core products is becoming more and more important. However, identified opportunities to differentiate have to be reviewed in the context of overall corporate targets and strategy. In some cases somebody else might be the best one to lift the value and selling

a business could be the preferred option. But deciding on an informed basis is crucial.

The importance of customer and market intelligence intensifies further downstream of the value chain. More complex customer requirements but less market information being publicly available or purchasable off-the-shelf. Whereas upstream mainly transparent commercial terms drive the business relationships, further downstream customer relationships are driven by a blend of customer interests. Here, commercial terms are often only one part of the equation, equally important as others, e.g. technical support, fulfilment or the potential to enter development co-operations. This knowledge on markets and customers can also be used for optimized product planning and production processes based on identified win-win situations.

This requires marketing managers not only adding new skills but also embracing a more and more entrepreneurial approach. Encounters with customers' personnel will require more proactivity and cover more areas of expertise – beyond commercial terms and fulfilment.

Business models other than the pure commodity play do require skills enhancing the understanding of product properties and its relevance for the respective clients' applications, since price gradually loses its status as the main buying criterion to services the further downstream the industry moves. Depending on the required depth of technical or end-user industry knowledge, technical or industrial sales teams support commercial sales and relationship management functions. Internal interfaces between

marketing/sales and functions like product development and R&D/Innovation will become more important.

Based on this understanding of markets and customers, a marketing and sales concept can be developed. It would contain all key aspects of the marketing and sales process and lead to knowledge about the right channels to the customers and how to manage them well, product planning, the profitability of product and customer segments. It would allow to act accordingly through customer segment oriented service and, hence, cost management flanked by the right strategic and tactical pricing mechanisms. All these contribute to finding the appropriate level of efforts for a given customer situation which will reflect in optimized resource allocation and resulting margins.

From the perspective of MEA/GCC chemicals companies in their current position or on their way downstream, this is the most difficult of all challenges. Most of that knowledge is often sitting with the foreign JV partners or e.g. via off-take agreements per definition not part of their playing field. These are legitimate sales channels and in many cases the preferred choice out of an informed evaluation process. In some cases, however, they might be the heritage of forces from distant times and may not be suitable anymore.

This is why more agreements with split responsibilities of marketing and sales according to region or a different criterion show up. This is an important step towards a holistic understanding of marketing and sales, given the global character of many chemicals. Partnerships potentially leading to full acquisitions as recently seen with Arlanxco or previously seen instant take-overs like GE Plastics by SABIC can give a strong and intense boost of involvement in marketing and sales for the players in the region. After such transactions, coming from a position of low marketing exposure, it might be tempting to accept the prevailing landscapes of marketing and sales standards as being sufficient and maybe even difficult to involve oneself in existing marketing and sales processes and decisions let alone challenging them.

This can be dangerous as the understanding of markets and customer needs are the mostly neglected issues in the industry – worldwide. This is due to still prevailing attitudes at the incumbents to produce and “wait for someone to come by and pick up the product”. This has worked well in the past and is understandable since the “DNA” of the industry asks for a safe and efficient production of valuable materials – which in itself is a huge task. But in times of increasing commoditization customers get more demanding.

Admittedly, it is not easy to run a chemical plant exactly according to erratic demand since chemical reactions/plant designs set limits. However, creating a unique organizational setup with an entrepreneurial spirit and operation mode are again areas for true competitive advantages.

And here is where today's immaturity can be developed towards a competitive advantage:

While many of the long established global suppliers have accumulated a fragmented landscape of tools to manage customer relationships which allow for only limited overall transparency on margins by customer or product segment, MEA/GCC chemicals companies have the opportunity to get it right from the beginning. In respect to the aspired business model a suitable business support landscape can be established with much less inherited constraints or global complexities. Latest CRM technologies and big data methodologies as well as reporting tools allowing for a high degree of transparency, can be implemented easier without such fragmented systems and a sales force that from a users' perspective has no willingness to change. Having the backbone of the systems in place before joining the global M&A party will set the direction for the PMI.

Addressing organizational set-ups typical for MEA/GCC chemicals companies

Successful and sustainable implementation, be it in strategy, innovation or marketing & sales can only be achieved through a successful change of the organization, its processes and people.

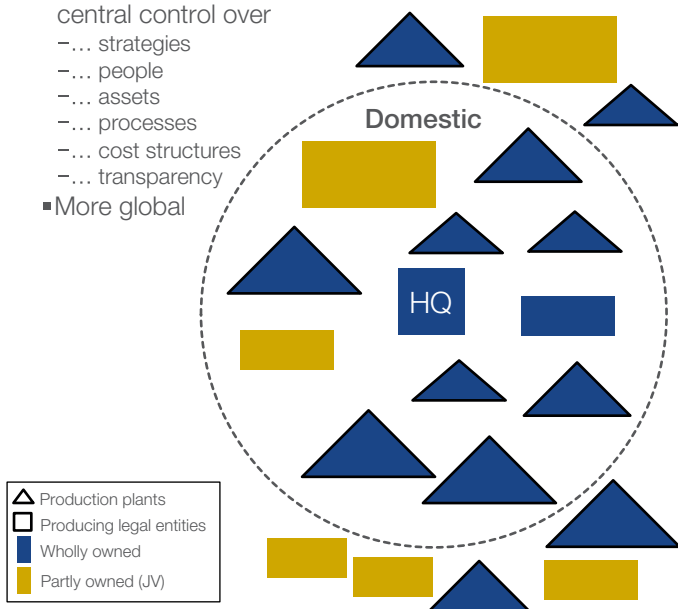
Irrespective of industry and region, this is best achieved by involving people early-on in the development of solutions. Many good ideas and solutions have never become effective in organizations because this natural law on how human beings function was neglected. But even if it is not neglected and in contrary given a high priority, bringing real change to large organizations is a very complex task.

Looking at this from a corporate perspective, the way how MEA/GCC (petro-) chemicals companies are built does not make things easier. Historically grown on project-by-project basis mostly in form of JVs with all kinds of ownership scenarios: some in the meantime being wholly-owned, others with majority shares above and below 50% with local and mostly foreign partners from all over the world. This has implications, which differ to many other chemicals companies in the world (Figure 7).

Figure 7: Typical corporate structures of chemicals companies

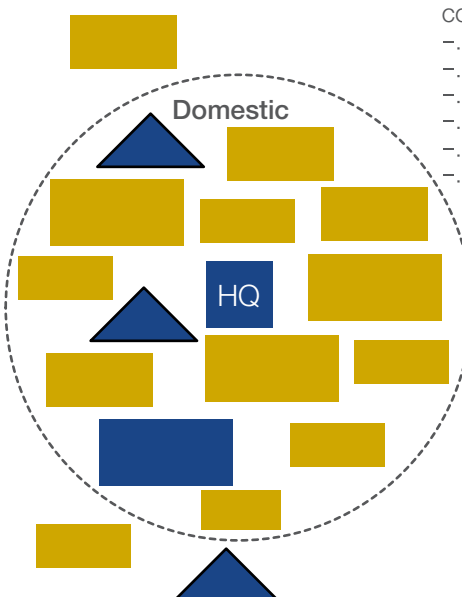
“Traditional” in the West

- More wholly-owned with central control over
 - ... strategies
 - ... people
 - ... assets
 - ... processes
 - ... cost structures
 - ... transparency
- More global



MEA / GCC

- More JVs with shared control over
 - ... strategies
 - ... people
 - ... assets
 - ... processes
 - ... cost structures
 - ... transparency
- More local (still)



Source: KPMG Stratley

One is concerning the overall corporate structure and the parent company's operative role and effectiveness in imposing centrally directed policies across its holdings. These concern all types of regulations as well as steering or harmonization of business processes where desirable within a corporate, e.g. portfolio management, corporate wide cost controlling and optimization measures, best-practice processes and managing them along highest standards (e.g. HSEQ), transparency, excellence initiatives or synergies-oriented asset management through best leverage of in-house-services and procurement activities.

Another implication is concerning the identity and culture of a company and the people development accordingly. The culture of the headquarters is in many cases influenced and enriched by multiple international JVs already in the home country, all having developed their own cultural blend of the host-company's and respective foreign partner's individual cultures.

Managing these different international environments in the homeland certainly prepares and qualifies for similar JVs abroad if part of the overall strategy. However, in case of taking over companies overseas, awareness of one's own multi-faceted culture will be important for a successful integration process.

A centrally steered initiative aiming for collection of best practices across all local JVs potentially leads to a catalogue hard to come by elsewhere. And it may reveal interesting insights on one's own corporate culture after all, its areas of diversity and homogeneity. This in turn will be vital for any solution development and related change initiatives in the future.

5. Conclusion

We observe a steady decrease of companies' growth coming from leapfrogging product innovation. M&A is becoming an alternative to fill this gap. This global phenomenon coincides with diminishing availability of local feedstock and melting advantage of it, compared to world-market prices. This is due to US shale combined with a period of lower oil prices and less dynamic growth coming from Asia/China all at the same time.

It is now on MEA/GCC players to take that challenges positively and turn them into an opportunity to become better companies with more sustainable processes and reaching the next stage of professionalism and globalization.

For both, incumbents and emerging players, a respective analysis along dedicated business models can help guiding towards a future positioning backed-up by own strengths and considering external market dynamics and trends.

As a result, we can already observe a convergence of the global chemicals industry where competitiveness becomes more and more a matter of discipline in a number of smaller levers rather than through few high-impact innovative improvements.

This convergence may be further driven by MEA/GCC chemicals companies taking advantage of the described M&A dynamics by acquiring selected business segments which from a Western KPI view do not fulfil the required portfolio criteria anymore due to continuous commoditisation. Applying some of the benefits of this region, e.g. still comparably low feedstock prices, will help those businesses improve their positions again.

Also mergers within GCC countries are likely to be explored by leading GCC players to create the critical mass to benefit from shared services, utilities, procurement as well as innovation efforts and people development, all pre-requisites for global competitiveness.

Besides big strategy also marketing, innovation and organization realignment will become more significant levers for differentiation and competitiveness and have to be designed along the needs of the chosen underlying business model. These will be increasingly important to compensate for the decreasing competitive advantages from local factors.

About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have 155,000 people working in member firms around the world. Our in-depth know-how on business, regulatory and transaction-related topics is brought together within our Advisory function and we have established interdisciplinary teams dedicated to key industries. These pool our experience around the world and further enhance the quality of our advisory services. Commitment and service depth in the chemical industry has also increased, as evidenced by the strategic acquisition of Stratley. Stratley, a German-based strategy consultancy for the chemicals and related industries, is a wholly owned subsidiary of KPMG in Germany.

KPMG International* also established the Global Chemicals Institute which is a world-wide knowledge sharing platform that details insights into emerging trends and critical business topics and where Chemicals & Performance Technologies industry professionals can access to valuable industry thought leadership and webcasts. Please visit us at www.kpmg.com/chemicals to learn more.

* The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

Authors

Till Knorr	Oliver Gawad
Partner	Head of Chemicals Strategy
KPMG Stratley	KPMG Stratley
KPMG in Germany	KPMG in Saudi Arabia
tknorr@kpmg.com	ogawad@kpmg.com
0049 162 1059501	00966 55 2278873

All rights reserved. No part of this document may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of Gulf Petrochemicals and Chemicals Association or KPMG.

© 2016 by Gulf Petrochemicals and Chemicals Association, KPMG Germany and KPMG Saudi Arabia





Disclaimer

The data, analysis and other information contained in this report is of a general nature and for informational purposes only and is not intended to provide any business, finance and investment advice. Nor does it address the circumstances of any particular individual or entity. Whilst reasonable efforts were made as we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. GPCA and KPMG make no warranties and assume no liability or responsibility for any inaccuracy, effort, or for any loss or damage in regards with or attributed to any action or decision taken as a result of using information for this report.

All rights of the publication shall be reserved to GPCA and KPMG, including the right to publish it by press or other communication, translate, include in database, make changes, transform and process via any kind of use. Full reproduction, copying or transmission of information from the report is not permitted without GPCA's or KPMG's written permission; however, the information may be used for educational and non-commercial purposes provided that GPCA and KPMG are fully acknowledged as the copyright holders.

The Gulf Petrochemicals and Chemicals Association (GPCA) represents the downstream hydrocarbon industry in the Arabian Gulf. Established in 2006, the association voices the common interests of more than 250 member companies from the chemical and allied industries, accounting for over 95% of chemical output by volume in the Gulf region. The industry makes up the second largest manufacturing sector in the region, producing over US\$ 108 billion's worth of products a year.

The association supports the region's petrochemical and chemical industry through advocacy, networking and thought leadership initiatives that help member companies to connect, to share and advance knowledge, to contribute to international dialogue, and to become prime influencers in shaping the future of the global petrochemicals industry.

Committed to providing a regional platform for stakeholders from across the industry, the GPCA manages six working committees - Plastics, Supply Chain, Fertilizers, International Trade, Research and Innovation and Responsible Care - and organizes six world-class events each year. The association also publishes an annual report, regular newsletters and reports.

For more information, please visit www.gpca.org.ae

Gulf Petrochemicals & Chemicals Association (GPCA)

PO Box 123055

1601, 1602

Vision Tower, Business Bay

Dubai, United Arab Emirates

T +971 4 451 0666

F +971 4 451 0777

Email: info@gpca.org.ae