

***SPECIALTY OR COMMODITY:  
TWO SIDES OF THE CHEMICAL COIN***

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***A. BACKGROUND***

The chemical business in the United States has undergone a major transformation in the past decade. This change was in direct response to the fact that there are few rapidly developing market segments and a great deal of consolidation of businesses. During this period, companies have struggled to increase market share and develop a business philosophy, which would allow the company to survive and succeed. This process has not been an easy one, and has resulted in acquisitions of many smaller companies, employee layoffs, plant closings, and the like. Many companies acquired smaller companies, then divested all or part of those acquisitions. Some companies have been more successful than others in making the necessary adaptations to market conditions.

In the chemical business a clear dichotomy has developed. Essentially two types of companies have emerged. On the one hand, there are the so-called "mega-producers" and on the other hand, there are true specialty chemical companies. Some companies have attempted to have elements of both commodity and specialty. This approach will become less and less effective as time goes on due to the basic differences in philosophy between the two types of business.

Purchasers of chemicals and those acquire samples during the developmental stages of a new product, need to consider which type of supplier will provide the most effective product and service. This is key strategic decision is made by many customers at least partly subconsciously.

Perhaps the most abused term in the chemical business is "specialty". Webster defines specialty as "a unique object or class of objects" while commodity is defined as "products of standard commerce". Clearly, the common usage of these terms is not in compliance with Webster's definition. We will attempt to highlight the differences between commodity and specialty chemical companies as we see them. We believe that the whole corporate philosophy and mode of doing business is quite different depending upon the type of company chosen by a customer.

## ***B. COMMODITY CHEMICAL COMPANIES***

Commodity chemicals are products manufactured by a number of companies, which tend to be of large volume with minimal product variation from producer to producer. This means that products are considered identical from an applications viewpoint and more commonly than not are an exact compositional match. Commodity products are heavily keyed to the price of strategic chemical building blocks and ultimately to the price of fats and oils or petroleum, which tend to be volatile. Generally, the technology used to make these products is in the public domain and hence available to anyone interested in making them. Availability of product, product consistency, price and price stability is key factors to determine which commodity supplier best meets the customers needs. Companies whose purchases are based only on price, generally find that price is their only satisfaction.

The companies, which are successful in the commodity type of business, are those with:

- 1) the lowest fixed costs,
- 2) the greatest vertical integration,
- 3) the economy of scale (i.e. those that can produce the largest volume at the lowest cost),
- 4) the largest turn over of inventory,
- 5) the most depreciated plant,
- 6) the lowest acquisition premium paid for acquired companies.

Once a company has made a commitment to be a successful commodity producer, there are several long-term changes in the management style and direction that occur. These changes grow out of the above requirements. Sales relationships rather than market understanding becomes a key factor. Lower fixed costs can mean deep cuts into Research and Development programs, divestiture of related businesses and the like. While these changes can result in a temporary relief from financial pressures, the long-term prognosis is that the new product development will suffer and the company will need to continue further down the commodity road.

Vertical integration means that a company will need to make many of its own raw materials, or compete with its customers. Both can be major changes. As plants are built that make several types of products, co-products and byproducts, the company must develop an efficient group to sell all the products that the plants make. Otherwise the whole operation will not have the desired profitability. This changes the method of sale and corporate philosophy from meeting a customer's needs to selling out a plant.

Economy of scale and the largest turn over of inventory are interrelated and require that the threshold amount of business that the company would work to obtain would become very large. Commodity producers are generally interested in materials that vary little from the standard products they produce and which can be

purchased in large volumes.

### ***C. SPECIALTY CHEMICAL COMPANIES***

A true specialty chemicals company is innovative and provides solutions to customer's needs. The company basically sells a service, namely the ability to solve in a cost-effective manner the customer's applications needs. Specialty chemical companies stress making what the customer wants to buy and not what the plant can make.

Successful companies in the specialty chemical business will have the following common features;

1. **Technical Ability / Broad technology** - Research and Development facilities and talent are a significant investment and a major functional unit to the specialty company. What is produced in the plant today, came through the laboratory some time ago.

2. **Applications Ability / Forward Integration** - The first submission of the specialty chemical company is to understand the customers process and problems. Personnel trained in the customer's discipline are likely members of the chemical Specialty Company's team.

3. **Marketing Ability (vs. Sales Ability)** - It is amazing how many companies still don't separate the sales and marketing function. The most basic difference can be explained by the analogy that the sales function is like a fire department, they put out fires that exist in the market and in so doing generate sales. Marketing is always busy starting new fires for sales to work on. Marketing is the discipline that looks for the new opportunity. Specialty chemical companies tend to have aggressive marketing people, as well as technically trained applications orientated sales people.

4. **Innovation / Flexibility** - Just as the market changes rapidly for the vendor, the customers market also can rapidly change. The specialty supplier must offer innovation in using all the technology available in modified ways and be willing to offer scale up and other equipment to key customers. New customer opportunities incite opportunities for new products as well as modifications of old ones.

5. **Niche Marketing / Customer Relationships** - Specialty suppliers realize rapidly that they cannot be all things to all people. This type of company must define the business units that are important and define those customers that are receptive to a technical sales relationship. Contact with other accounts need to be minimized in order to get the best return from the use of the vendor's development talents.

6. **Value Added Philosophy** - Specialty suppliers must provide the customer with more than a product alone. Each customer has its own service requirements. Some customers may require statistical control of processes, special quality control tests, or special inventory requirements. The specialty chemical company will be flexible enough to accommodate customer requests.

7. **Constant Product Improvement** - Specialty suppliers must be sensitive to the competitive environment in which their customers must work. New and more cost effective products must be the constant goal. A product is "improved" not only by virtue of the introduction of some technical improvement, but is improved because it meets a new requirement of the customer. Those requirements are always changing based upon the marketplace. An ongoing dialog between supplier and vendor on new requirements is a hallmark of a good specialty chemical company. This results in a cost-effective product which is generally more profitable to both the manufacturer and the customer. It also results in less dependence upon volatile basic raw materials.

#### ***D. DETERMINING COMPANY TYPE***

The determination of the type of company with which one is dealing is generally quite simple. The sales representative will be the first clue. Commodity suppliers will generally send in sales representatives who are interested almost exclusively in "me too products" and will ask such questions as "What do you buy in large quantities?", or "If I can save you a few cents can I have an order?". Specialty sales representatives will be more inclined to ask "What are your current development projects?" or "What functionality do you seek in your product?" Specialty chemical sales people concentrate on getting projects that offer a potential both to their customer and their company. They generally don't lead with questions about price or volume.

#### ***E. SUMMARY***

In summary, there are two basic types of chemical producers. This evolution has been the result of market pressures and will ultimately result in stronger suppliers as they find their niche. Both types of companies are needed in today's market but generally fulfill different functions to customers. Companies that buy chemicals should determine which type of company meets their needs for a given project and buy accordingly.