



MIDYEAR OUTLOOK

2020 chemical
industry outlook

At the end of 2019, we produced our 2020 outlook for the chemical industry. Given the disruption and impact caused by COVID-19, we've evaluated the key trends, challenges, and opportunities that may affect your business and influence your strategy for the remainder of 2020. Check out our midyear trends:



Planning for the recovery ahead

In response to the COVID-19 pandemic, the US chemical industry stepped in to help the government and health authorities fight the spread of the disease and save lives. The industry responded to the health crisis by pivoting its production capacity toward the products and materials needed to combat the outbreak, such as isopropyl alcohol and ethanol. Industry players ensured a strong supply of chemicals required to produce antibacterial wipes; disinfectants; hand sanitizers; surfactants for soaps; and personal protective equipment, such as masks, gowns, and face shields.

However, this is occurring in a market landscape where demand and prices for critical materials such as polyethylene and polypropylene have slumped on weakness in automotive, construction, and consumer markets.¹ As a result, Deloitte expects chemical industry revenues in the United States to decline 14 to 15 percent year over year in 2020.² Moreover,

depressed oil prices have changed the playing field and have eroded traditional, regional feedstock cost advantages for US companies. There is already a significant decline in European and Chinese feedstock prices, and if this trend continues, it could heavily affect US companies' competitive cost advantage.³

To successfully navigate this changing landscape, chemical companies can consider the implications of declining demand on their businesses and plan their next steps to deal with the crisis. Their initial responses will likely be similar to those in past economic downturns—focusing on operational efficiency, asset optimization, and cost management. However, this economic downturn is likely to be different, and chemical companies' next actions should not necessarily be what they were in the prior recessions.



End-market applications

End-user applications become a primary focus

While many signals from major end markets point to turbulence, there are pockets of positive signs that offer directional improvement. Pharmaceuticals, nutrition, and hygiene industries are trending upward, while the automotive, construction, and consumer industries will likely trend downward during the next six months. With a renewed focus on diversifying product portfolios, end-user applications become the primary focus for most chemical companies, and they can use this crisis as an opportunity to adjust their product portfolios. Chemical companies could consider aligning their product strategy with market shifts, prioritizing demand, and using existing and near-term trends to capitalize on new sources of demand, such as providing hygiene products and services like antibacterial coatings. This includes deemphasizing low-demand segments, rationalizing product stock keeping units (SKUs) to reduce complexity, and reassessing pricing tactics. Commercial excellence is often critical in this time of crisis, and chemical companies that show adaptability in product portfolios, pricing, sales and marketing effectiveness, and innovation could do well during and after the crisis.

Some companies are already executing on these tactics. The Dow Chemical Company, for example, repurposed its existing facilities to manufacture hand sanitizers by leveraging

operational flexibility, particularly in batch manufacturing, to diversify production based on current prevalent demand.⁴ Furthermore, companies can utilize material informatics to drive faster innovation and entry into growing application segments. For instance, Solvay has partnered with The Boeing Company to produce face shields for airline passengers.⁵ However, these shifts are relatively easier to achieve when moving to a product line that leverages a company's existing asset and skill base.



2

Supply chains

More agile and flexible supply chains are needed

The COVID-19 crisis has exposed supply chain gaps and highlighted the challenges of globalized supply chains, as well as the value that robust supply chains provide in hedging against risk. Many US supply chains have been severely disrupted, as restrictions and recovery plans have varied around the world, creating significant challenges. While rapid changes in demand are forcing the need for flexibility in the supply chain, emerging protectionist policies are driving companies to bring home some of their supply chains to mitigate regional risks.⁶ Consequently, chemical manufacturers may have to take a different approach to build resilience and robustness in supply chains, including inventory management, especially for items that are experiencing a surge in demand. They might need to maintain higher levels of inventory and create safety stock to mitigate supply chain risk. There could also be a heightened need for increased transparency and awareness, as companies have realized that just-in-time inventory can be risky when disruption occurs. However, this could be challenging, as it requires significant investments from chemical companies in a business environment where the industry is primarily focused on preserving cash and reducing capital expenditures.

On the other hand, China appears to be investing significantly in infrastructure to offset the economic downturn, which

includes several new refineries and numerous petrochemical projects to double down on its chemical manufacturing capabilities.⁷ Moreover, the US petrochemical industry faces another challenge—rising inventories and congestion at ports as supply exceeds demand, hitting exports. Demand from the traditional US export destinations, such as Europe, has shrunk as their sluggish economies and end-user industries grapple with the crisis.⁸ These developments seem to make the creation of a robust, multisourced supply chain a necessity for most US chemical manufacturers. US chemical companies can minimize their supply chain risks and potential disruptions by taking actions across sourcing and procurement:

- Reconfigure supply chains to broaden supplier networks across various firms and geographies
- Shorten long supply chains and hedge against supply disruptions by leveraging regional suppliers and multisource supply tactics
- Mitigate supply chain risk by raising inventory safety stock levels
- Improve visibility and transparency across the supply chain



3

Digital

Digitalization is accelerating

Even as the chemical industry has been experiencing continuous adoption of digitalization over the past few years, this crisis will likely fast-track the process, with a newfound focus on flexibility and agility. This is because chemical companies could chart a path to recovery by boosting their technological infrastructure and capabilities by digitalizing processes and operations to improve safety, cost-efficiency, and sustainability. For instance, in April 2020, BASF introduced a digital sales platform for its polyisobutene products in the United States, which is expected to enable US-based customers to place orders, track status, and make payments through an online interface.⁹

Companies that do not recognize this large shift in technology could lose ground with customers. So, they should focus on digital transformation to modernize their manufacturing operations and back-office activities. Manufacturing plants could see an increased push toward digitalization and automation to reduce production disruptions created by the limited workforce. And technological development in communication and collaboration tools will likely proliferate, with increased investment in remote conferencing and virtual reality applications. The primary digital trends, which will likely reshape the chemical industry in the next few quarters, include:

- Higher adoption of advanced technologies, such as artificial intelligence and intelligent automation, to enable continuous and efficient operations
- Increased virtualization of the workforce, as remote work will likely continue in various forms unrelated to the pandemic outcome
- Growing use of online and remote channels as more customers favor digital channels and experiences

As end-user applications now drive market demand, companies should continue their push to focus on versatile and agile digital technologies, including remote and Internet-based sales. However, as more companies look to move their businesses toward digital platforms, it can increase their risk of cyberattacks, requiring increased attention to strengthening cybersecurity.





Mergers and acquisitions (M&A)

M&A activity to drive value creation

The next few quarters are expected to present chemical companies with strong financial discipline the opportunity to double down on crucial elements of their strategy, including M&A. As many industry players focus on divestments of noncore or underperforming assets during this economic slowdown, companies that are well-prepared and have robust balance sheets could make smart acquisitions that create increased shareholder value. The industry may experience a short-term decline in M&A volume in the next quarter or two, with some planned acquisitions likely hitting pause as companies reevaluate their cost structure and capital expenditure. However, M&A activity is likely to start rebounding by the end of 2020, driven by:

- Companies reassessing their strategic priorities, including new strengths and weaknesses in their business models
- Newfound need for vertical and horizontal integration
- Increased opportunities from distressed companies, which includes the divestiture of noncore businesses to raise cash



Competing in the COVID-19 era

The effects of the COVID-19 pandemic will likely echo well beyond 2020, and the crisis provides an opportunity for companies to learn and adapt. Business leaders should use the crisis as a catalyst to rethink which end markets and applications to focus on and to accelerate the adoption of digital capabilities to increase efficiency. In addition, the COVID-19 era will likely require chemical companies to reevaluate their traditional supply chains to protect and strengthen their core businesses. Furthermore, they could divest noncore and underperforming assets and consider M&A opportunities to help drive value. While companies take immediate action to improve control of business operations and recover lost value, they should question the kind of company they want to be coming out of this crisis. Chemical companies that navigate this crisis and recovery most adeptly could be well-positioned to take full advantage of the opportunities to come.



Let's talk



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