Challenges and Opportunities for Agrochemicals in China

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The agrochemicals sector in China has achieved much in the past 20 years. It is one of the four leading global exporters of pesticides along with the USA, Germany and France (all four of which have about 12-13% of global share), and the country saw the highest export growth since 2010 (+134%). Unlike most other countries, the market is dominated by local companies rather than by the top six global market leaders. And while exports are still dominated by active ingredients, the share of formulations in total exports increased from about 35% in 2013 to about 40% in 2014.

As a consequence, the segment attracts its fair share of talent. Many of them attended a recent conference in Shennongjia organized by Farm Chemicals Internationals and sponsored by Chinese fertilizer and glyphosate producer Xingfa. Presenting at the conference, Management Consulting – Chemicals took the opportunity to ask the attendants for the biggest issues their respective companies face. This paper summarizes some of these issues and aims to give high-level advice on how to deal with the main challenges as shown in Fig. 1.

Strategy

As the recent past has shown, Chinese agrochemical companies have not always been particularly adept at selecting and timing their investments right. Price increases for materials such as glyphosate are followed by an investment boom, and the resulting overcapacity leads to losses throughout the industry.

This calls for more thorough strategic planning. Currently this planning seems to be driven primarily by the price and market situation (external factors), and it seems to be short term rather than also including the longer-term outlook. Instead, companies need to take internal factors into consideration. The key question to ask is whether the company has any capabilities or resources that give it advantages compared to the majority of potential competitors. If so, the company may still manage to be profitable even if the overall market situation is unsatisfactory. If not, it may be better not to pursue the targeted investment. And the planning horizon should be extended to cover at least the next 3-5 years (the exact length depends on the size and amortization of the investment), which in turn will require an analysis not only of the own investment but also that of competitors in the same area.

Particularly SOEs active in agrochemicals also face the issues in adapting their strategy to changing environments. It is best for such companies to establish a strategic planning process which has an incorporated permanent review mechanism, e.g., on an annual basis. Otherwise the strategy may too easily be outdated and no longer suit market requirements.

When selecting projects to pursue, it similarly pays to follow a structured process rather than just the gut feeling of top management. Another important aspect is to collect solid data to base the decision on. Skimping on market information costing a five-figure dollar amount can later lead to losses which easily exceed one million dollars.

Many Chinese companies are relying on their sales and distribution channels as a source of market information. Sales staff are able to gauge the market's size, pricing and customer needs faster than a third party. Furthermore, in a market such as China where personal relationships often blur the boundaries of a business, information flows more quickly and is impeded less by concerns about non-disclosure. This, and historically high growth, have led to a sense of antipathy towards data-driven strategic planning.

But it raises two problems. First, it means decisions are made not on the basis of strength of argument but because of seniority or strength of persuasion. For example, a few years ago a profitable company in Guangdong believed its industry was about to enter a cyclical downturn and wanted to diversify. The company asked an outside consultant for options, some of which were generally agreed to be attractive. However, the company's star sales manager argued passionately that they should be investing in property development, which they duly did. The industry's cyclical downturn ended up not being as severe as management believed while their property investments did not do well. A deeper analysis of data could have caused the company to question the sales manager´s view and to avoid the inferior path eventually taken.

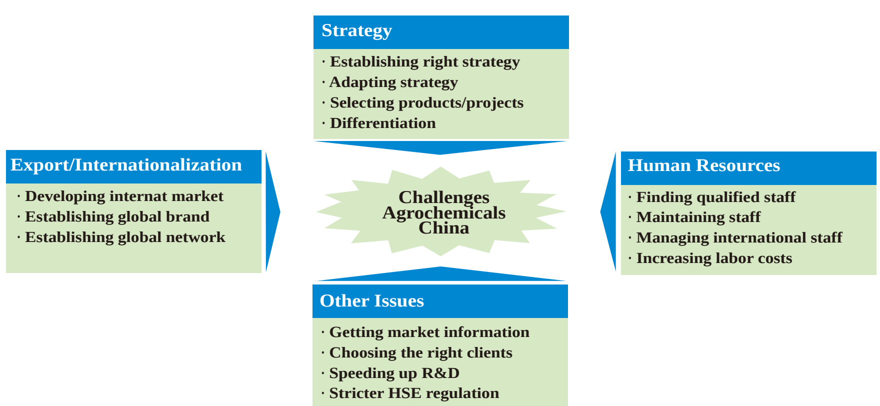

Fig. 1: Selected key challenges to agrochemicals in China

The second problem with not having a data-driven culture is that it is very hard to judge the dynamics of a market such as agrochemical. In a survey we conducted of 20 of China's leading pesticide producers, less than a third acknowledged a need to collect market data on a systematic basis, stating that they usually just look at the size of a potential market and decide if they could commoditize a solution cheaper than the market leader. However, many also admitted that one of their biggest challenges was to respond to new requirements for pesticide, which is faced with changing weather and environment, crop conditions and pests' evolving resistance. A corporation such as Syngenta can predict such changes faster and make the necessary product changes years before a Chinese competitor can respond.

In terms of strategic content, the majority of agrochemical companies would be well advised to pursue differentiation. While cost leadership almost by definition is only open to a small number of large producers, differentiation allows smaller players to be leaders in their specific niches and be profitable therein. Unfortunately, domestic agrochemical companies so far give differentiation too little thought, regarding it as a limitation of their business activities rather than as a tool to focus their activities and to excel in a specific area. However, chances for profitability are much better for a leading producer of a smaller pesticide than for the tenth-biggest glyphosate producer, even if total sales are the same. Other pathways of differentiation may be the focus on specific export countries (e.g., Rotam´s success in Latin America), specific formulations or product groups.

Export/Internationalization

A large share of China´s agrochemical production is exported. However, so far the majority of exports are still in the form of active ingredients rather than formulations or even branded products. This typifies the commodity approach that many local producers take, and, to give due credit, have been successful with. Changing this represents a major opportunity for Chinese producers, but will require longer-term investment in the resources and capabilities to establish a brand.

Chinese agrochemical companies are well advised to closely observe the activities of major global agrochemical players in marketing and brand building. For example, Syngenta has built a strong brand in China mostly by marketing directly to farmers as their core customers, thus creating a pull which forces agrochemical distributors to carry their products. The direct communication with farmers is done by a multitude of seminars, trainings, competitions, local TV advertisements etc. This represents a huge investment in staff but also helps establish long-term high margins. Chinese agrochemical companies, which compete by promoting a lower priced product to existing channels, doing less direct marketing, should evaluate the benefits of such an approach in their key export markets such as Latin America, particularly once they have achieved their own registration in key countries.

Selecting key export markets is one of the many aspects of agrochemical decision making for which solid market information is required. Again, market sizing is just one element to determine how attractive a market is. For example, when it comes to certification, bigger markets are not necessarily better. The cost of certification required for each type of imported pesticide in Brazil starts at US$200 000 and can take five years to gain. Meanwhile Brazil has multiple taxation policies for transporting across state boundaries that many do not learn about until it is too late. However, smaller neighboring countries have costs raging fromUS$50 000 to US$200 000 for certification and can be awarded in less than three years. This could well be decisive in a go-no go decision. Another tactic, relying on detailed knowledge of the local market, is to acquire a distributor that already has import licenses. The export manager at one of the major Chinese producers recounted how his company did just this recently in Australia.

With complex formulations more nuanced feedback from multiple qualified sources is a valuable and underutilized way of learning facts on the ground. The majority of the Chinese agrochemicals companies we surveyed said they were wary of official data in other emerging markets as it could be manipulated to suit political ends, and did not want to use data from local research agencies either due to a lack of transparency.

Human resources

With regard to employees, the agrochemical sector faces similar issues as many other chemical segments in China. The segment is fragmented, with many smaller companies and high competitive pressure. As a result, many agrochemical companies find it hard to attract and retain good employees. Paying high salaries is not an option throughout the whole company, and the average small company size limits companies from offering attractive career paths and long-term perspectives.

However, it is recommended for companies to specifically select one of two distinct paths of dealing with above-average employees. One is to treat them as all others, which will lead to some gains in the short term but also almost invariably the loss of these employees in the longer run. The other is to specifically focus on the top 10-20% of employees and give them both a wide range of opportunities and trainings and substantial pay increases – even if this means having to reduce such increases for the more average employees. Ideally, pay should be highly related to measurable parameters of success, e.g., sales, profit or number of new formulations developed. This will also make pay increases somewhat more acceptable to those not benefiting from them.

Generally, offering training for top performers is another recommended key aspect, particularly if done outside the company. This should not be an ad-hoc decision but rather based on an individual long-term training plan for highly valued employees. Such a training plan should be updated annually, and based on an analysis of both the skill gaps of the employee and his/her further skill requirements in his/her current and likely future position. When done in this way, the training plan also demonstrates to the employee the commitment of the company.

The agrochemicals sector strongly depends on exports, and will in the future rely more strongly on marketing-related aspects such as establishment of brands and selling of formulations rather than active ingredients. This also needs to be reflected in the choice of employees. Traditionally, Chinese agrochemicals companies are too focused on the production side of the business. Therefore companies need to specifically hire staff with marketing and sales skills, and with the language and communication skills to work internationally. Such employees will also be better at dealing with potential employees in other countries as they have a broader exposure and better understanding to foreign cultures.

Other issues

Many other issues were highlighted during the conference, which can only briefly be highlighted here:

• Research projects are often not run efficiently – best practice is to establish a clear R&D management process. A key objective of such a process is to ensure that projects with limited commercial or scientific probability of success are eliminated at an early stage, while promising projects receive sufficient resources for a speedy implementation. Optimizing the R&D process is an area in which support from an outside consultant is strongly recommended.

• The choice of clients is another important success factor. This choice needs to be data driven and based on long-term considerations rather than short-term gains. With very few of the leading Chinese agrochemicals companies having established a subsidiary in emerging markets, they rely on their distributors to choose. Only one of the top 20 Chinese agrochemicals companies we surveyed said it had resources dedicated to collecting information about potential customers overseas.

• The importance and difficulty of observing existing HSE regulations was also emphasized by several participants. Here, it will pay to take a proactive approach as the growing government emphasis on environmental aspects will make it highly likely that existing regulation will become stricter, and implementation will be tighter. Any company anticipating such developments will therefore have a competitive advantage.

• Finally, getting good market information – and the difficulty of achieving this – was a key concern of many conference participants. Any company aiming for long-term success in the industry may consider cooperating with a strong provider of market information.

Given the increasing importance of off-patent agrochemicals – a particular strength of China´s companies – we believe China will likely soon become the leading global exporter of pesticides, passing the US, France and Germany. However, it will take substantial efforts from companies to achieve this in a way that does not only increase sales but also profits. We hope this paper gives some initial pointers on how to achieve this. ■

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