Published on *chemanager-online.com* (http://www.chemanager-online.com)

12.05.2016

Chemical Distribution in China

A Relatively Immature and Highly Fragmented Market with Huge Potential

So far, in the Western world limited attention has been paid to the Chinese market for chemical distribution. In fact, only last year´s ICIS list of the biggest global chemical distributors for the first time includes a major Chinese player, Sinochem Plastics, ranked at No. 5 with 2014 sales of about €3 bn. However, this high ranking alone – taking into account that Sinochem Plastics´ sales were almost exclusively generated in China – gives an indication of the importance of China´s distribution market.

Another approach to estimate the potential of chemical distribution in the People's Republic is to look at the total size of the chemical market in China versus the chemical market in the EU or NAFTA – with a 2013 size of €1,047 billion (data: CEFIC), it is about as big as the EU and NAFTA market combined. As a consequence, even if the share of chemical distribution in China is lower than in the West (some industry experts estimate that the share of distribution is 5-7%), the total chemical distribution market in China is likely to be larger than either that of the EU or of NAFTA.

Immature, Fragmented, Reluctant

A major reason for the limited focus on the Chinese market is that compared to the West, the Chinese market for chemical distribution is still relatively immature. A large number of participants are primarily involved in trading, often adding no more value than some personal relationships to individual customers or producers. And the market is highly fragmented, with even the biggest players such as Sinochem Plastics only accounting for a few percent of the total distribution market. In addition, Chinese producers of chemicals are often reluctant to rely on distributors except for exports, particularly state-owned entities which often are already overstaffed and have an internal distribution arm.

On the other hand, particularly for smaller foreign chemical producers in specialty areas such as electronic chemicals (e.g., for Japanese or Korean producers of photoresists), distributors are essential to amplify their resources in China.

Even many large multinational companies with a strong presence in China only serve a few customers directly and rely on distributors for 60-70% of their total sales volume in China. This holds particularly true for imported products, for which the local chemical distributor has the vital function of keeping stock worth the demand of several months.

As a consequence, a shift by global players to local production in China is often accompanied by a stronger focus on direct sales. However, this is not always easy to implement locally. Sometimes the headquarters target to move towards direct sales or to reduce the overall number of distributors is ignored by local management. While a reduction of the number of distributors is therefore part of the strategy of many global players, it is implemented less frequently, often out of a fear of short-term effects on chemical sales.

What makes a chemical distributor in China successful?

Of course, many of the usual success factors in chemical distribution also apply in China. It is important to have a strong portfolio of principals – for example, Azelis entered into the market as a distributor for CP Kelco´s portfolio of additives, and IMCD enhanced its standing after starting to distribute the products of FMC. Ideally, a distributor should have several complementary principals targeting the same customer industry, allowing dilution of distribution costs and offering the customer the benefit of a reduced overall number of suppliers, coupled with a greater number of products to choose from.

For distributors focusing on specialty chemicals, it is essential to have competent technical staff and the necessary support infrastructure such as application laboratories. This holds particularly true when serving local rather than foreign customers in China, as the former tend to require more technical service due to their lower level of experience (global companies, MNCs, sometimes just need to adapt global formulations to locally available materials and thus need less technical assistance). This in turn requires hiring and maintaining qualified staff – not an easy task in a country in which the average employee turnover is much higher than in Europe (about 20% per year), and where trading may not have quite the same positive reputation either.

Establishing the capabilities for successful distribution particularly of specialties therefore requires a substantial investment in resources and a timeframe not of days or weeks (the traditional timeframe of Chinese traders of chemicals) but rather of several months or even years. Not all current market participants are willing to take this step, particularly when coming from a trading background.

In contrast, it is less necessary to handle logistics and warehousing as the Chinese market now has strong and reliable companies that can take over these functions from chemical distributors – even though of course it increases the attractiveness of a distributor for a principal to have many offices, warehouses and own logistics services. However, choosing a reliable partner for these functions is still vital, particularly as the implementation of applicable regulation is getting stricter after the Tianjin explosions of 2015.

Market Trends and Transformation

Consolidation in China´s distribution market is happening, but it is a rather slow process, and given the sheer number of chemical distributors and the limited market share of even the biggest players, China´s distribution market is bound to remain much more fragmented than Western markets in the foreseeable future. In particular, some global players which strongly rely on the serial acquisition of competitors outside China have mostly relied on organic growth within the country, though Brenntag, IMCD and Nexeo have made individual acquisitions that greatly advanced their standing in the country. These acquisitions have focused on the somewhat lower-end application segments such as plastics and coatings, in which local distributors are particularly strong as the vast majority of customers are local companies.

In contrast, foreign distributors have a strong standing in many segments which have more global customers and require more technical support, e.g., electronic chemicals, or in segments which are regarded as more sensitive with regard to EHSQ aspects, such as food additives. The rapid growth of distributors such as IMCD and Azelis, which insist on applying their global standards throughout their operations in China and offer full transparency to their principals, shows that at least parts of the chemical distribution market are moving towards a Western level. In particular, this applies to those chemicals – mostly specialties – for which technical service and application know-how are important.

Another driver pushing both principals and customers towards Western distributors is the recent tightening of regulation after the Tianjin event. This has brought requirements which some of the local competitors cannot meet. However, chemical distribution is primarily a local business, with even foreign players relying on local staff for the vast majority of their activities. Due to regional differences, localization requirements go down to at least the provincial level or even lower.

In conclusion, chemical distribution has good growth perspectives in China now that in the wake of the economic slowdown the focus will also be on cost efficiency, not only on continued sales growth. Industry participants expect annual growth of the chemical distribution market in China to be about 1-2% higher than for the chemical industry as a whole. Assuming continued – though slower – growth of China´s economy and chemical industry, this is indeed an attractive prospect.

Autor(en)

Dr. Kai Pflug, Management Consulting - Chemicals

Kontaktieren

Managm. Consult. Chemicals
RM1302, 13/F CRE Bldg.
Wanchai, Hong Kong
China
Telefon: +86 1368 1873992