



Overseas Growth Opportunities for Chinese Agrochemical Companies

*Dr. Kai Pflug, Management Consulting – Chemicals (kai.pflug@mc-chemicals.com);
Daniel Philip Senger, CDI Global (daniel.philip.senger@cdiglobal.com)*

At first sight, the status of China's pesticide producers looks fairly healthy. In 1H 2019, revenue increased by 8% compared to 1H 2018. As production volume increased by only 2% (to 1.04 million tons), the revenue increase is mainly due to average higher prices (+6%), making pesticides one of the best-performing chemical segments.

However, despite this recent positive development, longer-term prospects are challenging. Overuse of pesticides is widespread in China, with one 2016 government report stating that Chinese farmers use up to three times the global average of pesticides and a paper by the University of Melbourne stating that "China is the world's largest consumer of agricultural chemicals, using more than 30 per cent of global fertilizers and pesticides on only 9 per cent of the world's crop land." Perhaps not surprisingly, Greenpeace estimates that 70% of pesticides used in China are not absorbed by plants but contributed to pollution of soil and groundwater.

As a consequence, China has set a zero-growth target for domestic pesticide usage during the period of the current 13th Five-Year Plan (2016 to 2020), substantially

tightened regulation of pesticides, banned a number of pesticides and has proposed the ban of several others in the next few years, including Omethoate, Chloropicrin and Carbofuran.

Domestic volume growth thus is no longer a viable growth engine for China's pesticide producers. Of course, developing higher-end pesticides with higher value and lower negative environmental impact is still possible and promoted by the government, as in the case of biopesticides. However, this is a slow and expensive process as both R&D on new active ingredients and their registration require long periods of time and high expenditure for trials and registration.

Alternatively, China's pesticide producers may seek to increase their exports of pesticides, either in terms of value or volume (or ideally both). China is already the biggest global exporter, accounting for about 15% of global pesticide export market share, and these exports have been increasing in the last two years. Key export destinations are Asia (in particular, South East Asia, with Vietnam, Thailand and Indonesia as key targets) and Latin America, in particular Brazil, the biggest global importer of pesticides.

Unfortunately, recently China's pesticide exports have only increased very slightly. 1H 2019 saw an increase of 2.6% compared to 1H 2018, a value far below the rate of previous years. In addition, 1H 2019 saw a reversal of an earlier trend, the increase of formulations in Chinese exports. While from 2011 to 2017, the export of technicals declined from 63% to 56%, since 2018, technicals exports have been increasing again to 61% in 1H 2019. Of course, this goes along with corresponding changes in the share of formulations. This is somewhat worrying as the value captured in exporting formulations is higher than that of exporting technicals. In addition, several active ingredients including large-volume pesticides such as glyphosate are at a risk of being banned in selected export countries. For example, according to an expert estimate, about 50% of the value of Chinese pesticide exports to South East Asia is at risk of such a ban. This makes it necessary to increase sales of alternative pesticides in order to even stabilize current exports.

What are the main obstacles for Chinese producers of pesticides to sell their products abroad?



Registration of technicals and formulations in export markets can be very time-consuming and expensive. For example, in the important Brazilian market, it can take up to 6 years to register new formulations. The process is complex and inefficient, involving 3 different ministries with somewhat overlapping responsibilities. In addition, registration requirements differ by country.

Another major issue is local distribution and branding. This may not be relevant for the export of technicals as distribution in such cases is typically being done by the local formulator. However, given that the value captured from the export of formulations tends to be higher than that of technicals, Chinese companies should certainly aim to focus on formulations and thus will also require local distribution capabilities. Indeed, for this reason Kampuchea is a favored export destination for Chinese pesticide producers. The country lacks own production capability and thus relies on imported formulations.

In the past, Chinese players also frequently lacked good management staff to deal with overseas business. As China is getting more and more experienced in global markets, its understanding of local marketing and distribution will improve, thus alleviating some of the current issues. The success of some Chinese agrochemical companies such as Rainbow and NutriChem shows that firms with experience in foreign trade and working with multinationals can help Chinese companies to be successful

abroad.

Other risks that are hard to mitigate include climatic factors and exchange rate risks. Overall, risk management is a common weakness of Chinese agrochemical companies, explaining the recent loss of interest in the Argentinian agrochemical market. Smaller private Chinese companies lack the resources to take such risks while for state-owned entities, the incentive structures favor risk avoidance over taking risks that are likely to improve overall profitability.

Given these obstacles, what can Chinese pesticide producers do to increase their exports of technicals and particularly of formulations?

An obvious solution is to cooperate with local agrochemical companies in the export countries. Typically, such local companies have a very good understanding of the local market requirements as well as experience in product registration.

However, relying on such external partners means giving up a substantial share (often 30 to 50%) of the overall profit. We therefore expect Chinese companies to increasingly establish their own presence in the most important pesticide markets overseas. While in principle such a presence can be built organically, the option to acquire a local player seems much more attractive in order to accelerate the process and to guarantee inclusion of the necessary capabilities for a successful market presence. And indeed, several Chinese agrochemical companies are looking at the acquisition of manufacturers and channel vendors in export markets.

A similar approach taken is to buy shares of enterprises in export regions, and subsequently strengthen technical cooperation and channel cooperation with associated local enterprises.

Historically, Chinese agrochemical producers have focused on the manufacturing of active ingredients but been weak in R&D. Partly this is a question of mindset and timeframe – R&D is risky and takes time, making it a particularly difficult proposition for smaller companies. However, as the active ingredients permitted in different countries change, agrochemical producers need to be able to offer alternatives. Chinese producers currently often are not capable of doing so but need to invest into R&D in order to compete with the global players.

Most of all, Chinese players need to start thinking in providing solutions rather than providing molecules. This is a change in mindset that global players have already made, but which has been slow to be adapted in China. In the long run, an exclusive focus on manufacturing chemicals will not be successful. Of course, offering solutions rather than molecules also requires a better understanding of the agrochemical market than currently available to most Chinese players.

However, given the strengths of Chinese players in producing pesticides, exports from China are likely to grow further, though at a lower growth rate than in the past. In particular, exports to Africa, Eastern Europe and Central Asia look promising for Chinese export growth. ■