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Big Customers are Paying Good Money to Reduce Their Use of Chemicals

How Some Suppliers are Turning Chemical Management Services to Their Advantage

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Chemical Management Services Gains Traction

New Industries, Offerings Expand Initiative

Major consumers of chemicals are paying chemical management service (CMS) providers to reduce their overall spending of chemical purchases and handling. A growing army of CMS providers, including major chemical suppliers, are targeting the business to capture margins that are typically higher than those for materials supply alone particularly as many big suppliers such as auto makers are demanding continuous year-over-year price reductions.

CMS was spearheaded by General Motors and its key suppliers in the late 1980s, and is now widely used by large manufacturers in the automotive, aerospace and microelectronics sector. In the past two years, CMS providers have started to push the effort into end markets such as food and beverage processing, power generation, and pulp and paper, with help from a surprising source: an alliance of environmental groups seeking to reduce chemical usage and minimize waste.

The CMS provider lineup consists primarily of chemical makers, including Henkel—the largest with sales of nearly $200 million—as well as Ashland Specialty Chemicals, BP's Castrol unit and PPG Industries. Mid-size chemical makers such as Houghton and Quaker Chemical have also set up CMS operations. The field is expanding to include a group of emerging providers that do not produce chemicals. The largest is Haas TCM (West Chester, PA), with sales of $150 million/year. Others include AvChem (St. Charles, MO), which was spun out of Boeing; and Interface (Greenville, SC): Both target aerospace customers.

A study conducted by CMS Forum (San Francisco), a program of the environmental group Chemical Strategies Partnership (CSP; San Francisco), found that about $112 billion/year were spent on chemical purchases in the U.S. in 2000, excluding sales to other chemical makers. Of that, it estimates that the potential CMS market is $10.5 billion-$13 billion in the initial target markets such as aerospace, automotive, microelectronics, metalworking and utilities.

"Customers' understanding of total chemical management costs is usually incomplete, and outsourcing is viewed skeptically in-house," says Jill Kaufmann Johnson, director of CMS Forum said in the report. "The result is an expensive, inefficient bidding processes." CMS Forum and CSP are also pushing for more cooperation among CMS providers to improve standardization in the bidding process and improve CMS awareness.

"For every dollar spent on chemical purchases, there is an additional $1-$10 is spent on handling them," says Scott Follett, global director/PPG Total Services Solutions. A typical CMS program will reduce chemical handling costs by 10%-25%. "That gives you an idea of the kind of savings that can be generated," Follett says.

For every $1 spent on chemicals, $1-$10 is spent managing them.

Chemical suppliers say they welcome the opportunity to supply value-added services. "Chemical makers have had a tough few years," says Kent Bonney, director of Henkel's Chemical Management Services (Nashville) subsidiary. "Customers realize that you can only wring out so much from the physical cost of chemicals and procurement alone. CMS greatly expands the potential savings" for customers, and provides an additional revenue source for the supplier, Bonney says.

CMS contracts average 3-5 years and include several compensation methods, say providers. The key components include the cost of purchased chemicals; management fees, including the cost for employees a CMS provider may place at customer locations; and a portion of cost savings generated. A CMS Forum survey reported profit margins of 5%-30% for CMS providers in 2000. No CMS provider reports results separately, but most say their current profit margins exceed 10%.

Chemical makers that operate CMS units say they have set them up as stand-alone units, partly in response to customer demands that they remain neutral on product sourcing. "There's a preference to get our material into those plants," says one CMS provider. "But there are many cases where we are managing materials made by our competitors."

"We handle competitor coatings, especially in Europe where single-source supply contracts are still rare," Follett says. "The customer wants us to be neutral, and we are." Chemical makers also say there is no conflict embracing a business model that seeks to reduce overall chemical volumes. "We got past that 10 years ago," Bonney says.

Microelectronics was one of the early adopters of CMS. Most of the growth in CMS in microelectronics is occurring as existing customers move semiconductor fab operations overseas, particularly Asia, says Mark Kappes, operations manager/CMS at Ashland Specialty Chemical.

CMS offerings are becoming more sophisticated as they implement process improvements designed to improve efficiency and reduce overall chemical usage, as well as taking responsibility for related information technology, inventory management, training and safety programs, and environmental compliance reporting.

Those changes are illustrated by a major award given by GM to Quaker Chemical for a series of three-year contracts to provide CMS services at seven GM powertrain manufacturing sites. The sites represent 65% of GM's powertrain capacity in the U.S.

The profitability from the GM contracts will be tied to Quaker's ability to identify and implement cost reduction programs. In the past, Quaker simply consolidated the purchase of chemicals on a customer's behalf, and essentially resold it at a slight margin.

The change in services provided, along with a shift by CMS providers into new segments, has expanded the CMS market in the past year, says Thad Fortin, CEO of Haas TCM. "CMS has become accepted practice in automotive and aerospace," Fortin says. "Other industries are now moving to adopt it, including transportation, airlines, utilities and food and beverage," he says.

Haas and other CMS providers are also expanding their technical capabilities, Fortin says. "An increasing amount of our spending is going to improve our capability in information technology" and process technology management, he says. CMS providers are adding process and chemical engineers to work hand-in-hand with engineers at customer locations to improve production processes, he adds.

Fortin says that Haas TCM uses its capability strictly as a service provider, without production of chemicals, as a selling point with consumers. Haas merged with Radian last year to form Haas TCM *(CW, Oct. 16, 2002, p. 10)*.

Follett: Savings are significant.

Fortin: New CMS markets emerging.

Chemical makers say neutrality is becoming less of an issue as their operations function independently of the sales and marketing infrastructure of their companies. PPG and Henkel say they pursue CMS contracts in fields beyond what they produce. Bonney says that Henkel is collaborating with a water treatment provider, and hopes to be awarded a CMS contract soon with a major power utility, a first for the company.

Another new market is airlines, where Delta has had one of the few active CMS program. A CMS program operated by Interface has reduced Delta's overall chemical costs by 30%. Delta spends \$15 million-\$16 million/year of chemicals, excluding fuel.

CMS is also taking hold outside of the U.S., providers say. "There has been some movement in Europe but it has been slow," Bonney says. Providers say it is difficult because of work rules that limit outsourcing and the ability to place contract employees at work sites. Some auto makers are starting to adopt it, however. CMS Forum is working to expand CMS offerings in Asia and Europe, Kaufmann Johnson says. The group has received funding from governments in South Korea and Singapore, and CMS trials are being planned for the automotive sector in Korea, and for electronics makers in Singapore. CMS Forum is also near an agreement with the U.K. government.

Producers say being compensated on performance-based metrics and fees, and not just chemical sales is increasingly important, especially in the automotive sector where price negotiations can be brutal. Auto makers such as GM are incorporating provisions into contracts that guarantee year-over-year declines in material costs, sometimes 5% or more. "CMS contracts are a way to offset declines," says one producer. "We can add a service element and capture more of the supply chain."
—ROBERT WESTERVELT

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