DOW’S ACQUISITION PROGRAM

Dr. Koen H. Heimeriks and Dr. Stephen Gates wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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— “If one sheep leaps the ditch, all the rest will follow.”

English proverb

Dow Chemical Company (Dow), the U.S.-based chemical giant, had been moving from basic to specialized chemicals through mergers and acquisitions (M&As). With its $11.6 billion acquisition of Union Carbide Corporation (UCC) in 1999, Dow started off one of the most challenging acquisition programs in the chemicals industry thus far. Dow’s Executive Board called upon one of its most seasoned managers, Randy Croyle, to establish a Program Management Office (PMO). The PMO, later renamed the M&A Technology Center (the Center), was charged with preparing the UCC integration and was subsequently responsible for integrating all of Dow’s M&As. To successfully implement this acquisition program, Croyle created an expert team to put together Dow’s M&A methodology, which by the end of 2005 consisted of more than 100 codified in-depth integration templates.

As part of the acquisition program, Dow acquired Wolff Walsrode (Wolff) in 2006, a German specialty chemicals firm and part of the Bayer Group. This acquisition, combined with its existing cellulosics unit, helped Dow become a significant player in the cellulosics industry and strengthened its footprint in Central and Eastern Europe. Once again, Dow’s M&A methodology was applied to ensure the firms’ smooth integration. While the Dow-Wolff management team’s decisions followed the templates, deviations from standard procedures were also made due to the complexity of the project. Dow faced major challenges: it had to decide to what extent and how quickly it should integrate Wolff (a full or partial integration), and how to integrate the part of Wolff’s business that did not fit Dow’s portfolio.

While Dow announced the acquisition of Wolff on December 18, 2006, the closing of the deal happened in early July 2007. It was late in the afternoon on July 6, the first Friday after closing, when Croyle found himself in doubt. As head of the M&A Technology Center at Dow Chemical, he had just spoken with Bhavik Karia, one of Dow’s seasoned managers experienced in M&As, about the acquisition of Wolff Walsrode. From the Center’s founding, which coincided with his overseeing the integration of UCC, Croyle had remembered well one sentence in particular: “This will be the most successful integration in
our history.” Indeed, the UCC integration was widely acclaimed as one of the most successful integrations in the chemicals industry. But while the Center had been successful in integrating UCC and other smaller acquisitions, the question on his mind was whether Wolff would follow suit.

From UCC as well as other acquisitions, Croyle knew well that integration speed was one of the keys to success; besides the need to capture synergies quickly, providing internal reassurance to employees and continued external servicing of customers proved elementary over and over again. However, Karia had just asked for a three-month extension of the Wolff integration planning schedule. Being responsible for IT integration, which was a vastly important aspect in the integration, he told Croyle: “Let’s take time to understand what we have acquired before we go in on the first day and start implementing our methodology. While we can deliver the projected cost synergies by putting Wolff-Walsrode on Dow’s global IT systems and terminating its outsourced IT contracts, we should first evaluate its high-performance manufacturing processes and customer interfaces to see what we might need to adjust.” Clearly, they both knew that so far Dow’s M&A methodology was central to the success of its integration program. Croyle knew Karia was equally aware of the inherent challenges of acquisition integration and in particular the importance of integration speed. So why would he decide to postpone proven practice this time around?

The integration team had also discovered that a part of Wolff called Probis was functioning as an independent service provider, which could impact synergy potential. During Karia and Croyle’s conversation, Karia said, “We should be careful not to overpower Wolff — if we do, we may discard ‘a diamond in the rough’ called Probis.” In spite of a sound strategic rationale, had Dow potentially overestimated the synergy potential with Wolff? Since every deal is different, what level of integration should Dow aim for and what parts of Dow’s acquisition methodology should it use this time around?

THE CHEMICALS INDUSTRY

The chemicals industry had been dubbed “the industry of industries.” Its U.S. segment had recorded large trade surpluses and as of 2006 employed more than half a million people. Chemicals were among the largest industrial sectors in the European Union, especially in Germany, representing two-thirds of the manufacturing trade surplus and accounting for 12 per cent of manufacturing’s added value. The largest chemicals companies included BASF, Dow, Shell, Bayer, INEOS, ExxonMobil, DuPont, SABIC and Mitsubishi (see Exhibit 1).

The chemicals industry had enjoyed rapid growth for more than 50 years. Historically, the chemicals industry was concentrated in three areas of the world: Western Europe, North America and Japan (the Triad). The European Union remained the largest producer area.

Halfway into the first decade of the new millennium, the traditional dominance of chemicals production by the Triad countries, however, was being challenged by changes in feedstock availability and price, labor and energy costs, differential rates of economic growth and environmental pressures. Burgeoning demand in Asia, particularly in China and India, was resulting in more chemicals being produced there locally. Middle Eastern chemicals producers able to leverage their own natural resources had also benefited from this spike in demand.

Moreover, as of 2007, the volatility in financial markets and the credit crunch started to seriously affect the chemicals industry, slicing its margins and leaving capacity underutilized. How badly businesses were hit
depended on their position in the chain, with producers of bulk chemicals suffering more acutely than specialty chemicals companies.

One way to defend against the slowdown was to follow the M&A path, which was pursued by Dow as well as other incumbents. With the number of deals having grown progressively since 2000, chemicals companies marked a record for M&As in terms of deal size in 2006. To increase their size and to move into safer areas, companies took advantage of the economic environment to make major changes in their portfolios and ownership structures. They sold off various divisions to narrow the spectrum of their business, hoping to gain some protection (see Exhibit 2). Also, incumbents sold off or relocated part of their bulk activities to local markets by establishing large joint ventures with local investors in China and India.

The Specialty Chemicals Segment

The global specialty chemicals segment grew by 8.9 per cent over the 2001-2005 period and was forecast to grow by a further 28.9 per cent in 2005-2010. With an anticipated compound annual growth rate of 5.2 per cent over the 2005-2010 period, the market was expected to be worth $744 billion by the end of 2010. The chemicals industry in general, however, was expected to grow by about two per cent in the Triad countries between 2005 and 2015. China was predicted to have the fastest-growing chemicals industry at a rate of more than 10 per cent.2

Though Europe still commanded the largest share of the market, growth in demand for specialty chemicals had been declining across the region. Whereas in 2005 Europe was still leading, with a 34.5 per cent share, Asia-Pacific’s share (27.5 per cent) was expected to increase due to the rapidly growing specialty chemicals market in China, which analysts predicted would become increasingly important for future revenue.

The specialty chemicals market was highly fragmented. The market leader, Tokyo-based Shin-Etsu, commanded only 1.6 per cent of the market. The U.S. chemicals giant Rohm & Haas, which was acquired by Dow in 2009 as part of its acquisition program, followed Shin-Etsu and accounted for another 1.2 per cent. More than 95 per cent of the global specialty chemicals market consisted of players with market shares well below those figures. Given the highly fragmented market, the major players favored consolidation to boost sales; growth initiatives came from M&As and product differentiation. Many companies maintained broad product portfolios to insulate against fluctuating demand.

DOW AND ITS ACQUISITION PROGRAM

With more than $49 billion in annual sales and more than 42,000 employees worldwide in 2006, Dow was vying with Germany’s BASF to be the largest global company in the $1.6 trillion chemicals industry. Founded in 1897 in Midland, Michigan, Dow manufactured and sold chemicals, plastics, specialized products and services to customers in more than 175 countries, spanning the food, transportation, health and medicine, personal and home care and construction end markets.4 The company’s vision, developed in

1 Specialty chemicals are used in the manufacture of a wide variety of products including final chemicals, specialty paints and inks, and others. The market is calculated using the revenues of companies in the high value-added chemicals sectors.
3 The $15.3 billion deal makes it Dow’s and the industry’s biggest acquisition to date.