

Thomas Czigler,
Alexander Kaufersch,
Kedar Naik, and
Patrick Schulze

How cement companies create value: The five elements of a successful commercial strategy

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As the dynamics of the cement industry change, successful companies are creating value by focusing on their micromarkets. Here's how they do it.

It's no secret that cement companies continually struggle to generate returns on invested capital (ROIC) greater than their cost of capital. (See "[The cement industry at a turning point](#)," on McKinsey.com, December 2015.) That chronic underperformance stems in part from structural factors such as large fixed costs and fluctuations in supply and demand. However, many companies also have trouble creating and executing a coherent commercial strategy,¹ a substantial issue because, in many cases, it is one of the biggest nonstructural contributors to value creation.

The best-performing cement companies succeed by blending structural moves, such as changes in asset footprints or supply chains, with effective commercial practices based on a deep understanding of market dynamics. One large cement company in a key Asian country applied this approach to attain price and margin leadership in an important micromarket. It implemented rigorous cost controls and developed a long-term marketing campaign to build brand recognition with major customers. It also invested to expand bulk cement-production capacity well ahead of its rivals when analysis revealed that a growing wave of infrastructure projects would stimulate strong market growth.

How to build a program for profits

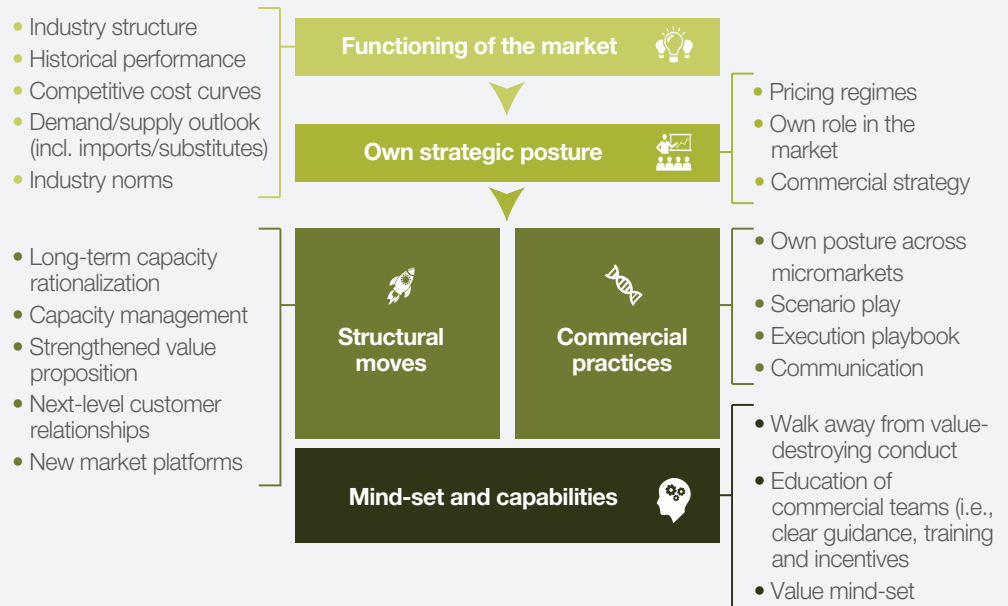
A structured approach to developing a commercial strategy and the discipline to follow through on it separates the winners from the also-rans (exhibit).

At the highest level, it's about mapping out the structure of the markets a company serves to identify value-creating opportunities, and then deploying practices to capture them. Our experience has taught us that the best performance results from companies executing along five dimensions:

¹ Because of the cost and complexity of cement logistics, there is no single global cement market but rather numerous micromarkets, the great majority of which are located within approximately 200 km of a cement plant. Some micromarkets are even smaller; competitors within them tend to have stable demand patterns and competitive positions.

Exhibit

Thinking through a commercial strategy for cement



McKinsey&Company | Source: Global Cement Service Line

1. Know what's really happening in the market

The CEO should begin by acquiring comprehensive market intelligence (within the bounds of the law, of course) and developing a clear view of the micromarkets the company competes in as well as its own position within them. The ultimate objective is to determine the best possible price and volume-placement approach for each micromarket. The model of each micromarket should be based on a combination of data, such as a granular forecast of demand by segment and of changes in supply; a profound understanding of each micromarket's pricing regime and potential transition points; and an accurate estimate of competitors' manufacturing costs, their landed costs, and their financial objectives and priorities. This analysis both provides a detailed picture of market dynamics and pinpoints opportunities to create value.

Understanding market dynamics is also important to help cement companies avoid two errors common to the industry. The first one is misreading the motivations and priorities of other market players. For example, cement executives might conclude that a competitor is acting irrationally when it seeks to maximize short-term returns rather than long-term cash generation. In fact, executives with a clear view of market dynamics would understand that the competitor is anything but irrational and is simply making a set of decisions based on different strategic objectives and priorities. As basic as this sounds, this ability to read the thinking of competitors is often missing when cement companies make commercial decisions.

The second mistake is overestimating the power of quick, easily reversible price cuts to generate sustainable market-share gains. These actions, in fact, often set off multiyear price wars and fail to achieve the intended sustainable share gains. That's because prices reflect the volume of product available in a given micromarket. Those volumes tend to remain fairly stable, because it takes time to add capacity and because producers need to work at or near full capacity to remain profitable. Severe price cuts are counterproductive because they unsettle the price-volume equilibrium.

2. Determine your strategy

Having gained a clear sense of market dynamics and opportunities, cement company CEOs can then define their own company's objectives, determine on which micromarkets to focus, and whether to position the company as a premium player or a low-cost producer. They can then set market-share aspirations, anticipate potential changes, and develop a set of strategic initiatives to address opportunities and issues.

Scenario modeling is particularly helpful in this regard because it allows a CEO to identify potentially emerging issues and think through the actions and processes (such as governance, escalation, and decision rights) needed to react to them. One practical approach we have seen is to compile a playbook of strategic initiatives to apply in different market scenarios. If, for example, competitors change their plant footprints, a CEO might consider responding by adjusting the geographical scope of the company's customer landscape.

Such a playbook might have helped an African producer that was recently blindsided by a surge of imports when shipping rates fell. The resulting glut forced the producer to lower its prices. The playbook could have also helped the producer prepare for the construction of new plants, which can quickly change the pricing dynamic in its key micromarkets.

The specifics of the strategy will necessarily vary from one company to the next, depending on variables such as each company's competitive position, its present-day capabilities, and above all its specific micromarket context. But with the help of scenario modeling, deep analysis of marketing dynamics, and appropriate goal setting, a CEO can develop a clear and practical strategy for growth.

3. Create structural advantages

With a strategy in place, top-performing cement companies map out the structural moves that will create competitive advantage in a specific micromarket. Structural moves to maximize profits include acquiring productive assets, taking production offline, dedicating production capacity to exports, or even shutting down kilns or integrated plants indefinitely (a rare move

that nevertheless can make economic sense). Alternatively, companies may conclude it is in their interest to segment their products and control their volume to manage capacity or refine their quality standards to strengthen their value proposition.

A producer with a leading position in Europe, for example, adjusted to a sharp drop in demand in one country by shutting down several kilns, keeping only its grinder active. The company then divested one of these inactive kilns in 2013. By the following year, it had reassigned its assets, which gave it control of an integrated plant and a grinder in a different micromarket.

In the mid-1990s, another company created structural advantages for itself in China by teaming with a joint-venture partner to focus on high-growth micromarkets there. After a few years, some of those micromarkets had matured. At that point the company divested its plants in those micromarkets and added capacity in other parts of the country that were still growing rapidly.

4. Test and implement commercial practices

Once the company has committed to its structural moves, it can build its commercial activities at the regional or micromarket level. To determine the most suitable course, the producer should simulate the impact of different tactical initiatives, such as more fine-grained customer segmentation or changes in the pricing regime, in various market scenarios. These simulations can provide some initial feedback about what moves are likely to have the greatest success and how the commercial team might profitably refine its tactics.

The team should then run live market tests to determine whether outcomes match expectations. To ensure that the commercial team executes the initiative effectively, the producer should prepare a blueprint that provides guidelines for recommended tactics and describes the likely effect of various scenarios.

5. Change mind-sets and build capabilities

Responsibility for developing and implementing a concise, legally compliant commercial strategy within a given micromarket rests squarely with the local or regional CEO. But its successful execution hinges on instilling a mind-set that supports the company's strategic objectives. If ROIC is the target, for example, a profitability mind-set should prevail (e.g. reduced discounts, maintaining price discipline). If cash generation is the objective, then a volume orientation would be more appropriate (e.g. discounting, volume pricing, trading losses for share). To build the appropriate mind-set in commercial teams, commercial leaders should adjust incentives to strike the right balance between

value and volume that supports the chosen strategy, and actively manage performance to provide timely feedback and direction to teams.

The choice of strategic objective will also dictate the strategic and commercial capabilities that the company needs to build. These capabilities include market-dynamics analytics communications to clearly articulate organizational priorities and, of course, market strategy. At the more tactical level, successful organizations invest in marketing (e.g. segmentation, customer experience), pricing (e.g. pricing to value), and sales (e.g. negotiating, sales operations) activities.

One way to build these capabilities is to create a center of excellence that spans the entire organization, including every national or regional subsidiary. The center can train commercial teams around specific scenarios, such as, for example, recognizing and reacting appropriately when a rival threatens to destroy value by starting a price war.



The cement industry may seem to be highly constrained. However, in executing these five actions, cement companies can, in fact, exert a high degree of influence over their own performance and drive substantial growth over time. □

Thomas Czigler is a specialist in McKinsey's Frankfurt office; **Alexander Kaufersch** is a consultant in the Berlin office, where **Patrick Schulze** is a partner; and **Kedar Naik** is an associate partner in McKinsey's Brussels office.