

LESSONS OF A CEO:

BOLD STRATEGY AND EXECUTION REMAKE ROHM AND HAAS



RAJ L. GUPTA

When Raj L. Gupta joined Rohm and Haas in 1971, the chemicals industry and the company were in growth mode. This created many opportunities for Gupta, who quickly rose through the ranks in a variety of roles managing businesses and regions. In 1999, Gupta became chief executive officer of the company. In that same year, Rohm and Haas acquired Morton International, LeaRonald and, subsequently, a number of other businesses, ultimately transforming the company into a \$7 billion provider of specialty materials and performance chemicals.

Although he had been with Rohm and Haas for nearly 30 years when he assumed the CEO role, Gupta observed that even his extensive industry and leadership experience could not fully prepare him for certain elements of the job. He learned through on the job experience, and gained continual insights about the CEO role through the insights of his own board and participation in outside board memberships.

Gupta recently spoke with Spencer Stuart consultant Patrick Walsh about the challenges facing a new CEO, the benefits of outside board service, managing the people side of M&A and the impact on the chemicals industry of soaring oil prices, private equity investment and geographic shifts in supply and demand.

Rohm and Haas has grown significantly since 1999, in large part because of the company's acquisition strategy. How do you think about M&A today in terms of building the pipeline, completing the deal and then integrating the acquisitions?

Raj Gupta: It's helpful to look at the acquisitions in the 1999 to 2003 period in a historical context. From 1993 to 1998, Rohm and Haas had good cash flow and good profit margins. However, a number of our businesses were reaching maturity in their life cycle. We also had some very profitable but non-strategic businesses like agrochemicals. After a careful evaluation of the Rohm and Haas portfolio, our leadership concluded that, if we were to remain a specialty company, we would have to evolve and change, and that required some divestitures. We also knew that, to fully compete on the global stage, the company needed to reach a critical mass significantly larger in sales than we were at that time. In 1997 and 1998, we identified the sectors we wanted to be in, what we needed to bring on in terms of technology and what had to be divested. We made nearly 40 transactions in a period of about 20 months. At that time, we were doing \$3.5 billion dollars in sales, completed \$6 billion dollars of transactions in less than two years, and created a company that was approximately twice the size it was when we began.

That's when you got your first gray hair.

Gupta: First gray hair is right! Looking back, I can say I'm glad we did it. We had to. But we also learned a few lessons. First, our timing might have been better. In 1999 and 2000, acquisition multiples were high. In retrospect we, like everyone else, probably overpaid for our acquisitions and therefore ended up with new assets, new people, a significant amount of debt — and an economic cycle that suddenly turned against us. If our crystal ball had been working better, we might not have taken on quite so much. However, I have to give the Rohm and Haas team great credit for executing well. A lot of companies sank under the weight of high debt and declining margins during this time, but we were able to manage our cash flow and financials and get through this period in relatively good shape. Our focus remained on two things: making sure we kept key people and businesses and maintaining positive cash flow. We did not make any further acquisitions during this three-year period, but we paid off \$2.5 billion of debt and increased our dividend every year. We remained a healthy company.

In addition to timing acquisitions right, it's important that the portfolio of the target company be very compelling. Buying market share is not enough. An acquisition has to bring new segments and new technology or new geography. Especially in the specialty chemicals industry, it's far better to have a focused portfolio of businesses.

What lessons did you learn about the people side of M&A?

Gupta: If there's one thing I feel we did really well, it was our focus on selecting leaders — choosing the right people for key jobs and retaining those leaders who might have been at risk for leaving. We went through all the internal candidates and the executives from the acquired companies and really tried to match the criteria for the position with the competencies of individuals. And we consciously did not just give all the key jobs to our legacy executives. Instead, we chose the best talent from the acquired companies and filled a number of positions, including business and functional jobs, with outside hires beyond that. As a result, today we have a strong, diversified and multi-talented leadership team with depth.

You've been at this company for 34 years. Talk a little bit about taking over as CEO as an insider and whether there were experiences that you wished you might have had before you became CEO.

Gupta: I certainly learned that the job of CEO is different; one is never quite trained for it until you are in the role. And then the learning begins! The issues you're dealing with are vastly different and new — far beyond what you face when running a function, a business or a geographic region. In earlier jobs, my primary concern was within a single business — the people, my P&L, my specific market challenges. As long as we delivered results, I could try different things. In the CEO role, my concentration is on the enterprise and how the sum of the parts creates the whole. I deal with investors. I deal with the board. I deal with government regulators and heads of state. There's an entirely new slate of constituents and issues to address. Just being able to manage the demands for my time among these new responsibilities was something I had to learn. And, in recent years, no one can deny that the demands on the CEO are increasing and are becoming more complex and more demanding. Just consider the impact of Sarbanes-Oxley on U.S. companies alone, and numerous other stepped-up governance needs.

Another lesson I have learned as CEO is to pay particular attention to communication — making sure that the message is consistent across all stakeholders — whether I am talking to colleagues inside the company, customers, investors, the board or the broader community. I have also come to understand the incredible importance of face-to-face communication, particularly when things are falling off the track a little bit. It was especially important in 2001 and 2002, when we were reducing bonuses to zero, there was downsizing, earnings were low and there was a lot of anxiety among employees and among analysts about the future of our organization. That was the time when I needed to be on airplanes, heading out to be in front of people, face-to-face. They needed to see me, and I needed to see them.

You are on the boards of Tyco and Vanguard. How has sitting on outside boards made you a better CEO?

Gupta: Before those boards, I served on the boards of three other companies, so I've been on a public company board now for the last 10 years. Board service is a valuable experience for any CEO, largely because, during those meetings, I find myself asking the kinds of questions my board asks me. Frankly, dealing with boards can be an ego-bruising experience for most CEOs.

As an outside board member, you bring broad experience and knowledge, but you certainly know less about that company than the sitting CEO. One of the things you quickly learn is that you cannot second-guess the CEO, but you can help him or her by asking critical, important and challenging questions about strategy, risk and talent. You can offer them advice. You can offer them suggestions, but at the end of the day you have to get out of their way and let them do the job they are paid to do. My external board experience also has allowed for more open discussions with my own board. If I am too close to the goings on of Rohm and Haas or the chemicals industry, they ask questions from their vantage point that force me to think through the issue in a way I might not have otherwise. It's a delicate balance for a board member; that is, to ask the right questions without trying to do the CEO's job.

How do developments such as \$60 oil, private equity and the emergence of China affect the chemical industry? Are these the big issues?

Gupta: The meteoric rise in energy and petrochemicals costs clearly will have a long-term effect on the industry. In the short term, companies have been able to pass along a portion of these energy costs down the value chain to the consumer. However, the next phase will be most challenging. My chemicals industry brethren will have to consider whether further price increases will push the limits of consumer spending. The U.S. chemicals industry faces an even tougher challenge because a significant part of the U.S. petrochemical industry uses natural gas as a raw material. We enjoyed many years when the U.S. natural gas prices were a strategic competitive advantage against the rest of the world — when gas was \$2 per mmbtu and oil was \$20 a barrel. But with natural gas at \$14, and oil sometimes breaking \$60 a barrel, it makes the U.S. chemical industry very uncompetitive. Another development will be biomass-based industrial chemical production as an economically viable alternative.

What about geographic shifts in the chemicals industry?

Gupta: Let's talk about geographic shifts from a couple of dimensions. First, the high oil and natural gas prices are causing a shift in petrochemical production toward areas where prices are still far lower, such as the Middle East today and, in the longer term, Russia. A move to that part of the world will naturally mean that the industry presence in areas like the U.S. Gulf Coast will likely shrink. Just as important, the downstream customer base also is shifting geographically, and quite dramatically so, seeking both lower labor costs and new and growing end-market opportunities. For example, the electronics industry is migrating rapidly to Asia, to China in particular.

This transition — the full combination of the shifting customer base, along with the shift in the supplier center of operations — is significant, real, and something for which chemical companies must prepare. It's inevitable. It's coming. The question is how fast can you dismantle and how fast can you build. The good news is that demand continues to increase on a global basis. There is, and will continue to be, considerable consumption of materials and chemicals in the developed part of the world, and that represents only 15 percent of the world's population. There's plenty of room for what I call geographic growth in those parts of the world where the other 85 percent of the population lives.

How about private equity? You run a large public company. You're in the market competing to buy assets and to buy companies and there's a trillion dollars in private equity sitting out there on the sidelines.

Gupta: There is a lot of money out there, no question. As private equity firms have invested in the chemicals industry and become more confident, they are doing bigger deals and becoming more aggressive. But I still see them, and they even see themselves, as transitional asset managers. Some of them have made a lot of money in a short time because their timing was perfect. There also have been many failures of private equity in the chemicals space. It might seem easy, but there is a lot of complexity and cyclicity to the business. If you don't time it right, then someone gets burnt. I guess this applies to the strategic investor as well.

The chemicals industry was a growth industry when you joined it; now it is much more mature. What impact does that have on developing talent?

Gupta: You have to look at the chemicals industry in segments. As a whole, the industry has matured like a lot of industries have. But, within the chemicals industry, there are lots and lots of opportunities for growth for materials going into traditional infrastructure and consumer markets, such as building and construction, electronics, automotive, power, water and so on. One, as I have mentioned, is the “developing world” where the bulk of the population lives. This will continue to be a source of organic growth. In the “developed” world, meeting emerging needs for personal care, safety, communications, leisure and energy will all drive demand for new materials. A second area remains the invention of new products and the processes to bring innovation to market. There is plenty of room for innovation and growth, which is likely to come from the intersection of the chemical, biological and physical sciences.

Are big companies hiring and developing future leaders for this industry in the same way that they did in the past?

Gupta: Yes. We always need new talent. It’s the lifeblood of what we do, though today, the kind of people skills we are seeking may be different from the types we sought in the past. For example, within the Rohm and Haas electronic materials businesses, we not only have a few chemists, but also physicists and electronic engineers who make up our R&D cadre. And where we are hiring and developing talent is changing as well. We still need good leaders everywhere, but right now we especially need them in Asia — in China, Japan, Taiwan and Korea — like everyone else. So the competition for talent is tougher and more urgent. Our industry and our company continue to offer great opportunities. The chemicals industry still files more patents than any other industry in the world. We are innovating; we are changing the way people live through the products we bring to everyday life. Our challenge is to help the world see that side of us, and to shed the incorrect image of the industry as mature, low-tech and low growth. I would hasten to add that there’s a bright future at Rohm and Haas, too. This is true especially in key business segments where our fastest-growing products reside and in areas of geographic growth, such as those found not only in Asia, but also in Eastern Europe and the Middle East, as well as Latin America.

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