

## **Chemtex Materials: Crisis in Export Division**

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### **Studies and Research**

*On December 13, 2010, Snehal Shah and Tapan Shah were in troubled thoughts. As Director Exports, both of them were in-charge of export division of Chemtex Materials Pvt. Ltd., Ahmedabad, Both of them had a joint conversation with one of the new customer in Turkey and their worst fears were confirmed. The client was refusing to take delivery of the order. The goods were with the customs department and Chemtex had to pay hefty charges for per day as client did not take delivery. This would potentially result in good amount of loss for the company.*

*“We need to do something about this quickly. We need to resolve this and revisit our export policy” Said Snehal to Tapan.*

### **Company Background**

Chemtex Materials Pvt. Ltd. was started in 1984 By Mr. Harmish, Mr. Mimish and Mr. Girish to mainly cater to ‘Hindustan Uniliver Limited’ (Hindustan Level Limited at that time). In fact, at start up the company was provided with the technology by HUL to start production for them.

The vision of the company is that ‘Chemtex Materials Pvt. Ltd. Envisions becoming the top most flexible packaging material manufacturer in INDIA by ensuring quality products & service.’

### **Mission of the Company**

- To offer quality products by using environment friendly methods.
- To ensure innovative packaging solutions to more number of companies.

The company is headed by the Chairman Mr. Girish Shah and then the Managing Director Mr. Hamish Shah. The company structure is divided based on functional areas with Marketing, Finance, Legal, HR & Admin and Exports. Total four directors head these functional areas. The organization chart has been highlighted in exhibit 2.

### **Plant Locations**

The company has five locations of its plant out of which four are in Ahmadabad and one is in Silvassa. The plant near Sanand district has been newly acquired and yet to start the operations.

In the products pouches are produced by three of its plants. Pouches produced by Silvassa plant are specifically as per the demand of Unilever. Wrappers are produced at the plant in Saket Industrial Estate, Sanand while wrapper antimould is manufactured at the plant in Dholka.

### **Business of the company**

HUL is the major customer for the company. More than 50 to 60% of its production is dedicated to HUL. They supply in multiple countries for HUL. Almost 70% of total production is for Indian companies (Including HUL) while 30% is for international market.

Chemtex is aggressively expanding business in international market via the route of exports. This also helps them in getting the government permission for import of certain raw materials which they require for production. The company exports its products to the following countries Argentina, Brazil, Congo, Cyprus, Egypt, Greece, Ivory Coast, Kuwait, Malaysia, Mauritius, Nigeria, Oman, Peru, Saudi Arabia, South Africa, Turkey, UAE, Yemen. All products of the company are exported as bulk orders on demand by the importers of the company. In international market also, significant part of the production is sold to multiple subsidiaries of HUL.

The raw materials used for production are Paper, PET, Ink, Pigment, Solvent, Adhesive, and Polymer. All input Raw is being tested in Lab. & maintain 3 Months batch stock for all in & out Material. Each dispatch will have quality certificate from the Lab.

### **Capacity of the Plants**

- Printed Job: 400 MT/ Month
- Extrusion Lamination Job: 490 MT/ Month.
- Antimould Wrapper Job: 600 MT/Month
- Capacity utilization around 60%

### **Corporate Social Responsibility (CSR)**

Chemtex provides fully furnished staff quarter for their employee. The company runs a trust in the name of Mr. VR Shah, Grandfather of the founders. The trust runs three schools among them two schools are for low cost family in the slum areas. The employee children get free education in these schools. Under the banner of the same trust the company distributes free study material for school children.

### **About the Packaging Sector**

Packaging Industry is an important sector, adding value to the various manufacturing sectors including agriculture and FMCG segments. The technology and innovation in this sector is improving day-by-day. The global packaging industry is currently valued at US \$433 billion and is expected to grow to US \$820 billion by 2016. This growth is primarily driven by factors like growing urbanization, investment in housing and construction, a burgeoning healthcare sector and rapid development in the emerging economies like China, India, Brazil, Russia and few other East European Economies. The consumer market dominates the global packaging industry and accounts for an estimated 70% of the sales, while industrial application accounting for remaining 30% of it.

### **Indian packaging industry**

The Indian packaging industry is a heterogeneous mix of industrial units in the organized and unorganized sectors comprising manufacturers of raw materials, packages, machinery and ancillary materials and equipment.

The Indian packaging industry, growing at an annual rate of more than 15 per cent, is valued at \$ 15.6 billion (INR 85,000 crore) as on 2013. In the next five years, the sector is expected to triple to around \$ 60 bn. The net profit of the packaging industry spurted 104.5 percent during Q3 FY08, against a growth of 29.5 percent in the December '06 quarter. The large growing middle class, liberalization and organized retail sector are the catalysts to growth in packaging. More than 80 percent of the total packaging in India constitutes rigid packaging. The remaining 20 percent comprises flexible packaging. There are about 600-700 packaging machinery manufacturers, 95 percent of which are in the small and medium sector located all over India.

Indian packaging machinery imports are \$ 125 million. The import (customs) duty for packaging machinery is 25.58 percent for 2007-08. Germany and Italy are the latest suppliers of packaging machinery to India but focus is now shifting on Taiwan, Korea and China. Indian packaging machinery exports are rapidly growing. India's per capita packaging consumption is less than \$ 15 against worldwide average of nearly \$ 100. The total demand for paper is estimated to be around 6 mn tones, of which about 40 percent is consumed by the packaging industry. Laminated products including form-fill-seal pouches, laminated tubes and tetra packs are growing at around 30 percent p.a.

### **The future**

The packaging industry in India has been registering a constant growth rate of 15%. The Corrugated packaging industry is however finding itself at the crossroads. Increasing prices of kraft paper, non availability of international standard papers at affordable prices, resistance of corrugated box user industry to offer sustainable prices, increasing competition, non viability of automatic plants are proving to be hurdles in the growth path.

Despite these adverse circumstances, the industry is all set to take on the challenges and look at the future opportunities. As global companies set up their manufacturing bases in India to meet the growing demand for consumer and white goods – the need for high quality boxes is appearing evident. Progressive Corrugators are setting up automatic board/box making plants to increase production and enhance performance of boxes. In house printing on corrugated is becoming imperative.

All this portends well for the industry. Insurgence of corrugated packaging machines from neighboring China and Taiwan will prove to be a threat as well as a great opportunity considering the inherent capabilities

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and experience of Indian Corrugated Machinery Manufacturers. Strategic alliances with overseas machinery manufacturers are already happening and will soon become a norm.

### **Converting Opportunities Galore**

The Indian economy is growing and so is the Packaging industry. As growth rides on increased industrial production and international trade, demands on package converters have become more intense and sophisticated. Within India, increasing penetration of organised retail (including foreign players who are large consumers of flexible packaging solutions) and increasing preference for branded products has added fuel to the demand for flexible packaging solutions. Machines and advanced technologies for printing and converting packaging materials for the Flexible Packaging Industry has come up to meet the rising requirement.

The Indian Label Industry is growing at a rate of more than 15% with several press manufacturers and label converters gearing up to challenges. The industry has rapidly evolved and is global in its outlook and delivery. There are close to 5,000 box plants scattered throughout the subcontinent in classic developing-country industry fashion, mostly fragmented and family-owned.

### **Gencer Soap: Opportunity or Problem?**

In the month of June 2010 Tapan received an email from Gencer Soaps. Snehal and Tapan were looking to enter the market in Turkey with the attractiveness of the market. They had studied the market and felt that they can expand their market in a potentially crucial country for their business. Turkey can be used as an entry point to European market.

Gencer Soaps is a soap manufacturing company with facility in Istanbul, Capital of Turkey. The company was looking for a quality manufacturer of packaging material and thus using a trade website, they contacted Tapan via email. Snehal and Tapan both were excited with the inquiry but decided to take it forward with caution.

Snehal said in a meeting with his team, "We have an opportunity to expand our market in Turkey but we need to be cautious. As this is the first contact with the prospective company, let us take as much caution as possible".

They began discussion with the customer on their requirement and they found that Gencer Soaps wanted packaging material for their different variants of soap. The quantity required per order was about 1 metric ton per variant per order.

For the purpose of quality, Gencer Soaps did not give exact specification. They sent their current packaging material and one sample of a competitor packaging material. The specification was given that the design should be based on our material and the quality should be what competitor is using for packaging.

The cost of setting up of the production using cylinders was about USD 15,000. Gencer Soaps wanted Chemtex to bear the onetime cost of setting up but Chemtex did not want to take the risk of the same. After a long time of negotiation, an agreement was reached that Gencer Soaps will pay USD 5000 as payment for cylinders in the first order. Subsequently in second as well as third order, Gencer Soaps will pay remaining \$ 10,000.

This process of negotiation consumed about one month. By this time, the prices of raw material had risen by 20% and Chemtex wanted to revise the initial quotation of price per metric ton. But Gencer wanted the order to be given at initial quotation only and finally it was decided that the prices can change from the second order. The terms of delivery were accepted as '**Documentary Collections**'. ('D/C' is described in detail in Exhibit 3)

Chemtex started the process after receiving a payment of USD 5000. Chemtex started designing the product specification and setting up the production environment. After an effort of about one month, the quality of the sample was passed by Gencer. Now Chemtex quickly moved to production.

The delivery of the material was scheduled by end of September and the material was actually shipped on September 30, 2010. The average time taken by ship is minimum 20 days for delivery. The ship reached port on October 23, 2010. The custom procedures were completed within a three days.

After the ship had reached the port, Gencer was supposed to go to bank and get the documents of cargo like Bill of Lading by payment of the amount due. No one from Gencer went to the bank for ten days. Even after continuous reminders, the company gave reasons like internal problems and documentation problems. Snehal said "I was starting to get worried now. This is where I felt for the first time that something is very wrong."

After clearance from customs, the shipping company normally allows any container to remain in their warehouse for 7 days without any charges. After this period, there are per day penalty charges as explained below.

<b>Charges</b>	<b>Week</b>
No Charges	1st Week
USD 25 per day	2nd Week
USD 35 per day	3rd week
Incremental cost per week is USD 10	

Also the maximum amount of time shipping company would hold the inventory is 1.5 Months to 2 months. After this period expires, Shipping Company will auction the goods and will recover its storage costs and auction cost. So Snehal was also worried about this.

Now the situation was getting serious. Snehal called the manager at Gencer and demanded an explanation. Manager assured that there were some internal issues with documentation and this will be resolved in one week. This dragged on for three consecutive weeks. Now Snehal was sure there is some major problem. He demanded for a conference call with the management of Gencer and it was arranged for December 13, 2010. In the conference call, management said that they are facing financial difficulties and thus they will be unable to take delivery of the product. Snehal and Tapan tried to explain the amount of loss Chemtex will have to incur because of this but they were unwilling to listen. They proposed an option that Chemtex should allow them to take delivery by changing the payment terms and they will pay later but Snehal and Tapan had lost the trust on the company and did not agree to the same. They said, at the end, they can't go ahead with the business and Chemtex should call the container back. The conference call ended on a bitter note.

Now Snehal and Tapan are reflecting on the entire deal while trying to figure out what went wrong. They need to present the situation in detail to the management and also need to plan how to resolve the situation.

### **Exhibit 1**

#### **Political, Economic and Legal Framework For Turkey**

##### **Political Aspect**

Turkey with its traditional Western orientation, relations with Europe has always been a central part of its policy. Turkey became a founding member of the Council of Europe in 1949, applied for associate membership of the EEC (predecessor of the European Union) in 1959 and became an associate in 1963. In 1987, Turkey applied for full membership of the EEC in 1987, became an associate member of the Western European Union in 1992, joined the EU Customs Union in 1995 and has been in formal accession negotiations with the EU since 2005. In the post-Cold War environment, Turkey's geostrategic importance shifted towards its proximity to the Middle East, the Caucasus and the Balkans. In return, Turkey has benefited from the United States' political, economic and diplomatic support, including in key issues such as the country's bid to join the European Union.

##### **Economic Aspect**

Turkey has the world's 15th largest GDP-PPP and 17th largest nominal GDP. The country is among the founding members of the OECD and the economies. In 1983 Prime Minister initiated a series of reforms designed to shift the economy from a statist, insulated system to a more private-sector, market-based model. The reforms, combined with unprecedented amounts of foreign loans, spurred rapid economic growth; but this growth was punctuated by sharp recessions and financial crises in 1994, 1999 (following the earthquake of that year), and 2001; resulting in an average of 4% GDP growth per annum between 1981 and 2003. Lack of additional fiscal reforms, combined with large and growing public sector deficits and widespread corruption, resulted in high inflation, a weak banking sector and increased macroeconomic volatility. Since the economic crisis of 2001 and the reforms initiated by the finance minister of the time, inflation has fallen to single-digit numbers, investor confidence and foreign investment have soared, and unemployment has fallen.

The European Union – Turkey Customs Union, which went into force on 1 January 1996, led to an extensive liberalization of tariff rates, and forms the pillar of Turkey's trade policy.

- Turkey has gradually opened up its markets through economic reforms by reducing government controls on foreign trade and investment and the privatization of publicly owned industries, and the liberalization of many sectors to private and foreign participation has continued amid political debate.

- The public debt to GDP ratio peaked at 75.9% during the recession of 2001, falling to an estimated 26.9% by 2013.

The real GDP growth rate from 2002 to 2007 averaged 6.8% annually, which made Turkey one of the fastest growing economies in the world during that period.

This growth slowed to 1% in 2008, and in 2009 the Turkish economy was affected by the global financial crisis, with a recession of 5%. The economy was estimated to have returned to 8% growth in 2010.

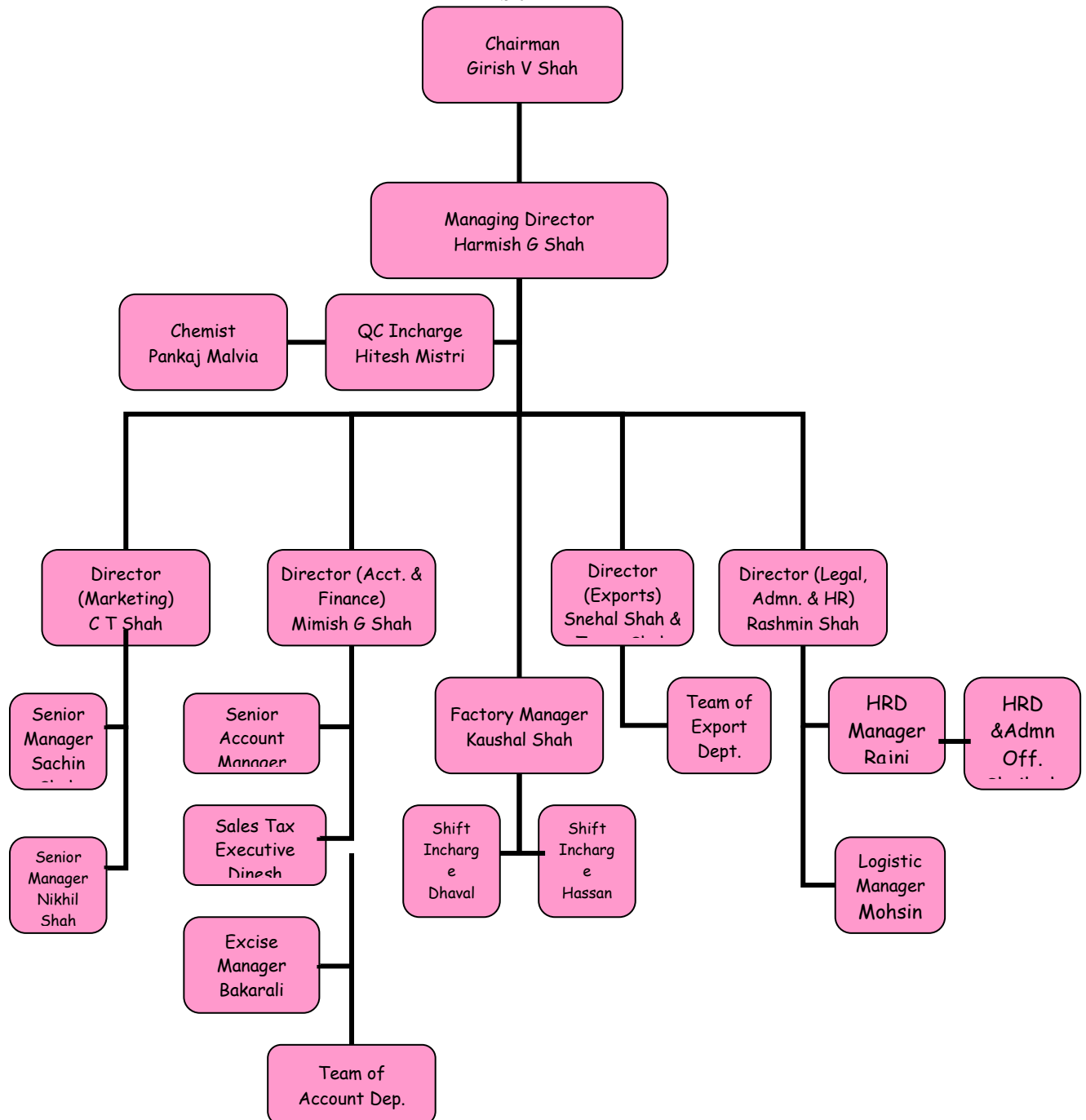
### **Legal Aspect**

In Turkey, Turks constitute 70% to 75% of the population. Minorities include Kurds (18%) and others (7–12%). Turkey's government is democratic, secular, and parliamentary, and executive powers are shared by the president and the prime minister, who leads the Council of Ministers (U.S. Department of State website, 2006).

Turkey has a poor record in protecting intellectual property rights, and complying with customs regulations is difficult. In addition, there is often a lot of red tape when investing or moving businesses to Turkey. However, the country has taken steps to become more favorable to foreign investors. On June 21, 2001, Turkey introduced the International Arbitration Law which allows foreign investors to be more comfortable in resolving their commercial disputes through arbitration. This law is intended to ensure a speedy dispute resolution and diminish intervention by state courts.

The enforcement of arbitral awards is subject to the issuance of an enforcement order by the Turkish court. Judgments of foreign courts, under certain circumstances, need to be reconsidered by local courts before they are accepted and enforced. Turkish law accepts binding international arbitration of investment disputes between foreign investors and the state, and this principle is included in the U.S.-Turkish Bilateral Investment Treaty. Turkey recognizes foreign arbitrators, which are enforceable under Turkish laws. Parties that are involved in a contract are free to choose a venue of arbitration to be held outside Turkey.

**Exhibit 2**



**Exhibit 3**

**Payment Terms in International Trade:-  
 Letter of Credit:**

A Letter of Credit, simply defined, is a written instrument issued by a bank at the request of its customer, the Importer (Buyer), whereby the bank promises to pay the Exporter (Beneficiary) for goods or services, provided that the Exporter presents all documents called for, exactly as stipulated in the Letter of

Credit, and meet all other terms and conditions set out in the Letter of Credit. A Letter of Credit is also commonly referred to as a Documentary Credit.

**Documentary Collections:**

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of the payment for a sale to its bank (remitting bank), which sends the documents that its buyer needs to the importer's bank (collecting bank), with instructions to release the documents to the buyer for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents.

D/Cs involve using a draft that requires the importer to pay the face amount either at sight (document against payment) or on a specified date (document against acceptance). The collection letter gives instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients, D/Cs offers no verification process and limited recourse in the event of non-payment.

D/Cs are generally less expensive than LCs.